No. 87-453-ASX Title: Amerada Hess Corporation, et al., Appellants
Status: GRANTED v.
Director, Division of Taxation, New Jersey Department of the Treasury

Docketed:
September 18, 1987 Court: Supreme Court of New Jersey

Vide: 87-464

Counsel for appellant: Moore II,Robert L.

Counsel for appellee: Hamill,Mary R.

NOTE* Notice of Appeal filed 8/20/87

Entry	Date	Note	Proceedings and Orders
1	Sep 18 1987	G	Statement as to jurisdiction filed.
2	Sep 18 1987		Appendix of appellant Amerada Hess Corp., et al. filed.
3	Oct 21 1987		DISTRIBUTED. November 6, 1987
4	Oct 21 1987		REDISTRIBUTED. November 6, 1987
5	Oct 21 1987	X	Brief amici curiae of Comm. on State Taxation, et al. filed. VIDED.
6	Oct 21 1987	X	Brief amici curiae of American Mining Congress, et al. filed. VIDED.
7	Oct 21 1987	X	Motion of appellee New Jersey to dismiss or affirm filed.
8	Oct 30 1987	X	Reply brief of appellants Amerada Hess Corp., et al. filed.
9	Nov 9 1987	P	The Solicitor General is invited to file a brief in this case expressing the views of the United States. Justice O'Connor OUT.
10	Feb 25 1988		Application of the SG for leave to file a brief as amicus curiae in excess of the page limitation, and order granting same by Brennan, J., on February 26, 1988. Brief not to exceed 30 pages.
11	Mar 16 1988		Brief amicus curiae of United States filed. VIDED.
12	Mar 23 1988		REDISTRIBUTED. April 15, 1988
13	Apr 6 1988	X	Brief of appellee Director, Division of Taxation in response to the United States as amicus curiae filed.
15	Apr 18 1988		REDISTRIBUTED. April 22, 1988
17	Apr 25 1988		REDISTRIBUTED. April 29, 1988
19	May 3 1988		REDISTRIBUTED. May 12, 1988
20	May 16 1988		PROBABLE JURISDICTION NOTED. The case is consolidated with 87-464, and a total of one hour is allotted for oral argument. Justice O'Connor OUT. **
21	Jun 29 1988		Joint appendix filed. VIDED.
22	Jun 29 1988		Brief of appellants Amerada Hess Corp., et al. filed. VIDED.
23	Jun 30 1988		Brief amici curiae of Comm. on State Taxation, et al filed. VIDED.
24	Jun 30 1988		Brief amici curiae of American Mining Congress, et al. filed. VIDED.
26	Jul 13 1988		Order extending time to file brief of appellee on the merits until August 13, 1988.
27	Jul 27 1988		Amended Rule 28.1 listing filed.
28	Aug 11 1988		Brief amici curiae of Iowa, et al. filed. VIDED.
29	Aug 12 1988		Brief of appellee Director, Division of Taxation filed. VIDED.

No. 87-453-ASX

Entry	Date	Note	Proceedings and Orders
30	Aug 18 1988		CIRCULATED.
31	Aug 26 1988	G	Application (A88-171) to extend the time to file a reply brief from September 11, 1988 to September 23, 1988 by the Appellants, submitted to Justice Brennan.
32	Aug 31 1988		Application (A88-171) granted by Justice Brennan extending the time to file until September 23, 1988.
33	Sep 23 1988	X	Reply brief of appellants Amerada Hess Corp., et al. filed. VIDED.
34	Sep 24 1988		Record filed.
		*	Certified copy of original record, box, received.
35	Sep 30 1988		Set for argument. Tuesday, November 29, 1988. This case is consolidated with 87-464. (4th case) (1 hr.)
36	Nov 29 1988		ARGUED.

(1)

87 453

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

AMERADA HESS CORPORATION *et al.*,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

On Appeal from the Supreme Court of New Jersey

JURISDICTIONAL STATEMENT

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39 pp

QUESTION PRESENTED

Whether the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution permit a state, in defining the taxable net income of a multistate corporation, to include income contributed by an exclusively out-of-state business activity but to exclude associated costs incurred solely on account of that activity.

LIST OF PARTIES AND RULE 28.1 STATEMENT

This Jurisdictional Statement is filed on behalf of the following appellants, each of whom was a party in the Supreme Court of New Jersey:

Amerada Hess Corporation
Atlantic Richfield Company
Chevron U.S.A. Inc.
Cities Service Company
Conoco Inc.
Exxon Corporation
Gulf Oil Corporation
Mobil Oil Corporation
Phillips Petroleum Company
Shell Oil Company
Union Oil Company of California

The remaining parties in the Supreme Court of New Jersey were:

Diamond Shamrock Corporation
Tenneco Oil Company
Texaco Inc.
Director, Division of Taxation, New Jersey Department of the Treasury

Because of their length, the lists of appellants' affiliates required by Rule 28.1 are set forth in Appendix I to this Jurisdictional Statement, pp. 105a-155a.

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Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

On Appeal from the Supreme Court of New Jersey

JURISDICTIONAL STATEMENT

Amerada Hess Corporation *et al.* appeal from the judgment of the Supreme Court of New Jersey, dated June 22, 1987, upholding the New Jersey Corporation Business Tax Act against appellants' claims that, as construed and applied, the statute is repugnant to the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution.

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (App. 1a-35a)[1] is reported at 107 N.J. 307, 526 A.2d 1029. The opinion of the Appellate Division of the Superior Court of New Jersey (App. 36a-42a) is reported at 208 N.J. Super. 201, 505 A.2d 186. The opinion of the Tax Court of New Jersey (App. 43a-49a) is reported at 7 N.J. Tax 51, and its opinion denying reconsideration (App. 50a-61a) is reported at 7 N.J. Tax 275.

[1] "App." refers to the Appendix to this Jurisdictional Statement.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on June 22, 1987. App. 1a. Notices of appeal to this Court were timely filed in the Supreme Court of New Jersey on August 20, 1987. App. 62a-83a. This appeal was docketed within 90 days from the entry of judgment below.

The jurisdiction of this Court rests on 28 U.S.C. § 1257(2). That section authorizes an appeal to this Court when the highest court of a state upholds a state statute against a claim that the statute, as construed and applied, is invalid under the United States Constitution. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 440-41 (1979).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The relevant provisions of the United States Constitution, the New Jersey Corporation Business Tax Act, and the Crude Oil Windfall Profit Tax Act of 1980 are set forth at App. 92a-104a.

HOW THE FEDERAL QUESTION WAS RAISED

Appellants raised the federal constitutional question in their amended complaints in the New Jersey Tax Court,[2] in their briefs in support of summary judgment before the Tax Court,[3] and in their briefs on appeal before the Appellate Division of the Superior Court and the Supreme Court of New Jersey.[4] The New Jersey Supreme Court considered and expressly rejected appellants' constitutional claims. App. 33a-35a.

[2] Appellate Division Joint Appendix for Plaintiffs-Appellants 518a-525a, 526a, 556a-562a, 563a-564a, 569a, 633a-638a, 640a, 646a, 708a-716a, 749a-755a, 760a-761a, 815a-821a, 822a, 859a-865a, 866a, 900a-906a, 907a, 936a-942a, 943a-944a, 949a, 994a-1000a, 1002a, 1031a-1037a, 1038a; Appellate Division Appendix for Amerada Hess 17a-22a, 26a-27a. Copies of the Joint Appendix (hereinafter "Pl. Jt. App.") and the Amerada Hess Appendix (hereinafter "Hess App.") have been lodged with the Clerk of this Court.

[3] Brief for Plaintiffs 70-87; Memorandum for Amerada Hess 44.

STATEMENT

Appellants are 11 vertically integrated oil and gas companies. They engage in all aspects of the oil business, including exploration, production, refining, transportation, distribution, and marketing. App. 2a. Collectively, they do business and own property in nearly all 50 states and the District of Columbia. Pl. Jt. App. 1132a; Hess App. 2a.

Since no oil is produced in New Jersey, appellants do not engage in that aspect of the oil business there. App. 2a. Several of them, however, conduct refining operations in New Jersey, and all of them market petroleum products in that state. App. 2a; Pl. Jt. App. 1132a-1137a; Hess App. 2a. They compete at both the wholesale and retail levels not only with each other but also with non-producer independent refiners and marketers.

All of the appellants are subject to the federal Windfall Profit Tax ("WPT"), imposed on the "removal" of crude oil from the producing premises, and the New Jersey Corporation Business Tax ("CBT"), a franchise tax measured by a corporation's "entire net income." The interaction of those two tax schemes, each of which is summarized below, gives rise to the present controversy.

As construed by the Supreme Court of New Jersey, the CBT precludes a deduction for the billions of dollars in WPT payments that appellants and others have made to the federal government since 1980. Because the WPT

[4] Joint Brief for Plaintiffs-Appellants 62-76; Brief for Amerada Hess 37 n.28. Under New Jersey appellate practice, when the Supreme Court grants certification to review a final judgment of the Appellate Division, "the appeal shall be submitted [to the Supreme Court] on the briefs, appendices and transcripts filed with the Appellate Division." N.J. Rule 2:12-11.

operates as a cost of producing crude oil, and because no crude oil is produced in New Jersey, the effect is to increase the New Jersey tax base, and consequently the New Jersey tax liability, of crude oil producers solely because of and in rough proportion to their exclusively out-of-state production activities. The question under this Court's decisions is whether the CBT, as interpreted, taxes a greater portion of multistate income than is fairly attributable to the business done in New Jersey and whether it imposes a discriminatory tax burden on out-of-state business.

A. The Windfall Profit Tax

During the 1970s, the domestic oil industry was subject to an elaborate system of price and allocation controls. The system was gradually dismantled between 1975 and 1981, when all regulatory authority was terminated. In late 1979 and 1980, shortly after the President began phasing out crude oil price controls, the world market price for crude oil soared, and Congress became acutely sensitive to the political implications of allowing domestic producers to sell at the substantially higher uncontrolled prices. In the Crude Oil Windfall Profit Tax Act of 1980, I.R.C. §§ 4986 *et seq.*, Congress addressed that concern by imposing "an excise tax on the additional revenue resulting from decontrol." *United States v. Ptasynski*, 462 U.S. 74, 76 (1983). "Without such a tax, decontrol probably could not [have gone] forward." Staff of Jt. Comm. on Taxation, *General Explanation of the Crude Oil Windfall Profit Tax Act of 1980*, at 26 (Jt. Comm. Print 1981) [hereinafter *General Explanation*].

The tax was intended to reserve for the federal treasury a "fair share" of the economic benefits of deregulation, thereby achieving "greater equity in the distribution of the gains from higher oil prices." S. Rep. No. 394, 96th Cong., 1st Sess. 6 (1979). Congress sought to "strike the appropriate balance between tax receipts that could be used for public investment or redistribution and industry incentives to increase domestic oil production." Cong. Budget Office, *The Windfall Profits Tax: A Comparative Analysis of Two Bills* xv (Nov. 1979); *see* S. Rep. No. 394, *supra*, at 6-7; *General Explanation* 6, 26.

By its terms, the WPT is "[a]n excise tax . . . on the windfall profit from taxable crude oil removed from the premises during each taxable period." I.R.C. § 4986(a). The transaction that triggers the tax is the removal of a barrel of crude oil from the producing premises. A barrel is "removed" when it is brought to the surface and "physically transported" away from the "immediate vicinity of the well." Treas. Reg. § 51.4996-1(d)(1). The producer must pay the tax regardless of whether it sells or otherwise disposes of the barrel of crude oil.

The measure of the tax—"windfall profit"—is the increase in the value of each barrel of crude oil at the wellhead attributable to federal price decontrol. The incremental value is a function of (1) the "removal price" less (2) the sum of the "adjusted base price" plus "the amount of the severance tax adjustment." § 4988(a).[5]

Congress included a "net income limitation" ("NIL") designed, as the New Jersey Supreme Court noted, "to

[5] The "removal price" is for most purposes the uncontrolled or world market price for crude oil. If a barrel is sold and then removed from the premises, the removal price is the "amount for which the barrel is sold." § 4988(c)(1). If a barrel is removed before sale (or is sold to a related person), the removal price is the "constructive sales price"—generally "the representative market or field price of the oil." § 4988(c)(3); Treas. Reg. § 1.613-3(a). The "adjusted base price" is the approximate price, adjusted for inflation, at which the barrel would have been sold in 1979 (before price decontrol). § 4989(a). The "severance tax adjustment" is the amount by which any state severance tax imposed on a barrel exceeds the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. § 4996(c).

insure that the W.P.T. would not be imposed on a company when the costs of production exceeded the income from a particular property." App. 6a. Under the NIL, the "windfall profit" on a barrel may not exceed "90 percent of the net income attributable to such barrel." § 4988(b)(1). The net income attributable to a barrel refers, not to the producer's overall net income from operations, but rather to its per barrel "taxable income from the property." § 4988(b)(2). A producer may have many properties, some profitable and others unprofitable, depending on the acquisition, development, and operating costs of each. Because "taxable income from the property," and therefore the NIL for each barrel, must be computed separately for each property, Treas. Reg. § 51.4988-2(b)(1)(i), a producer may have, in the same tax year, substantial WPT liability despite having no taxable income for federal income tax purposes.[6]

The Act divides domestic crude oil into three tiers and assigns to each an adjusted base price and a tax rate ranging from 30 to 70 percent. I.R.C. §§ 4987(b), 4989, 4991. The amount of tax with respect to each barrel of crude oil is computed by multiplying the "windfall profit on such barrel" by the applicable tax rate. § 4987(a).

For federal income tax purposes, WPT payments are treated as inventoriable production costs under I.R.C. § 471, and are therefore subtracted from gross receipts in determining a corporation's gross income. Alternatively, WPT payments in some circumstances may be

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[6] "Even if one oil property is producing oil at a profit substantial losses from other property may actually put the producer in a net loss position. The windfall profits tax will still have to be paid, however, on the oil produced from the 'profitable' property." Robison, *The Misnamed Tax: The Crude Oil Windfall Profit Tax of 1980*, 84 Dick. L. Rev. 589, 601 n.89 (1980).

reclassified and deducted from gross income as "ordinary and necessary" business expenses under I.R.C. § 162 or as taxes under I.R.C. § 164.[7] In assessing the federal tax impact of the WPT, Congress assumed that WPT payments also "generally would be deductible under State income taxes." H.R. Rep. No. 304, 96th Cong., 1st Sess. 9 (1979); *see* H.R. Conf. Rep. No. 817, 96th Cong., 2d Sess. 163 (1980); S. Rep. No. 394, *supra*, at 9; *General Explanation* at 9.

B. The New Jersey Corporation Business Tax

New Jersey imposes an annual tax (the CBT) on the "entire net income" of each corporation that does business in the state. N.J. Rev. Stat. § 54:10A-5(c). If a corporation does business both within and without the state, the CBT is imposed on the portion of the corporation's "entire net income" that is attributable to New Jersey under a three-factor apportionment formula representing New Jersey's share of the corporation's total receipts, payroll, and property. N.J. Rev. Stat. § 54:10A-6.

Federal taxable income is the starting point for determining "entire net income" under the CBT. The New Jersey statute provides that a taxpayer's entire net income is "deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax." N.J. Rev. Stat. § 54:10A-4(k).

The statute provides that certain federal deductions must be added back to federal taxable income for purposes of the CBT. Under the "add-back" provision (App.

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[7] Although inventoriable costs are subtracted from gross receipts in computing gross income, rather than deducted from gross income in computing taxable income, the ultimate effect on taxable income is the same. We occasionally use "deduction" in this Jurisdictional Statement in the broadest sense to embrace any cost subtractable either from gross receipts or gross income.

2a), "[e]ntire net income shall be determined without the exclusion, deduction or credit of: . . . [t]axes paid or accrued to the United States on or measured by profits or income." N.J. Rev. Stat. § 54:10A-4(k)(2)(C). Many state tax schemes employ comparable add-back provisions. They are intended to prevent erosion of a state's net income tax base through the deduction of similar taxes levied by other jurisdictions on the same base.

C. The Proceedings Below

1. *The Assessments*

At issue in this litigation are the 1980 CBT returns filed by all of the appellants and the 1981 CBT returns filed by five of the appellants.[8] Each appellant, in computing its New Jersey "entire net income," adjusted its federal taxable income in accordance with the requirements of N.J. Rev. Stat. § 54:10A-4(k). No appellant added back WPT costs to federal taxable income. All considered the WPT to be a federal excise tax imposed on the production of crude oil and measured by the value of the crude oil at the wellhead, not a tax on or measured by corporate income or profit within the scope of the New Jersey add-back provision.

The Director of the Division of Taxation, New Jersey Department of the Treasury, issued CBT deficiency assessments to appellants (resulting in certain cases in the reduction or disallowance of refund claims). The Director expressly based the assessments and refund denials on the failure of appellants to add back their WPT payments in computing "entire net income." Each appellant filed a protest. After conferences with the appellants, the Director issued final determination letters denying the protests. Pl. Jt. App. 1139a; Hess App. 28a-31a.

The add-back of WPT payments made a "substantial difference" in the tax liability of each of the appellants.

[8] The state has deferred final action, pending the outcome of this litigation, on the 1981 returns filed by the other six appellants and on the subsequent years' returns filed by all the appellants.

App. 44a. The amount and the percentage of each appellant's increased tax liability resulting from the add-back of WPT are set forth at App. 84a.

2. *The Litigation*

a. Each appellant filed a complaint in the Tax Court of New Jersey challenging the deficiency assessment or refund denial. The litigation raised essentially two issues: (1) whether the WPT falls outside the scope of the New Jersey add-back provision because it is not a tax "on or measured by profits or income," and (2) if the WPT is nonetheless within the scope of the add-back provision as construed, whether the statute, by disallowing a deduction for costs incurred solely on account of activities conducted exclusively outside New Jersey, conflicts with the United States Constitution. The Tax Court rejected appellants' claims on both issues. App. 43a-49a. It emphasized, in denying reconsideration, that its construction of the add-back provision turned, not on "whether the WPT *was in fact* a tax on or measured by profits or income," but rather on "what the [state] Legislature perceived it to be." App. 57a (emphasis in original).

b. On appeal, the Appellate Division of the Superior Court reversed. It determined that, "[b]ecause the WPT is payable without regard to the profitability of the oil producers' overall business activities," it "is not a tax on or measured by profits or income" and thus does not fall within the add-back provision. App. 39a, 42a. That provision's "purpose," the Appellate Division noted, is "to preserve undiluted for state taxation the same tax base upon which federal income taxes were computed." App. 41a. The provision "should not be read to include legitimate business expenses," such as WPT costs, because adding such expenses back to the tax base could "create tax liabilities in spite of overall losses," contrary to the fundamental design of the CBT. App. 41a. In light of its construction of the statute, the Appellate Division had no need to address the constitutional issue.

c. The New Jersey Supreme Court reversed the judgment of the Appellate Division and reinstated the judgment of the Tax Court. The Supreme Court acknowledged that, unlike the CBT, the WPT is "imposed on production at the wellhead" and that its measure is not a company's "overall net profits or income" but rather the incremental value of a barrel of crude oil at the wellhead resulting from decontrol. App. 5a-6a. It accordingly recognized that the WPT is not "directed at the same income base as the C.B.T." App. 33a. Nevertheless, based on "the principle of probable legislative intent" (App. 10a), it concluded that the WPT fell within the add-back provision.

Even without adding back the WPT deduction, New Jersey would enjoy a significantly expanded tax base, and materially higher tax revenues, because of the impact of price decontrol on the net income of crude oil producers. The New Jersey Supreme Court nonetheless theorized that, "if the Legislature had anticipated the enactment of the W.P.T., it would have been concerned," that the "deductibility of the W.P.T. would shrink the State's tax base." App. 11a. For that reason, according to the Court, "the Legislature probably would have viewed the W.P.T. as a tax on the 'profits' and 'income' of oil companies, thereby avoiding a revenue loss." App. 11a.

The Court next considered the constitutionality of the statute as interpreted. First, it held that disallowing a deduction, even for costs incurred solely on account of out-of-state activities, does not implicate the territorial limitations on state taxing power imposed by the Due Process Clause. So long as the state employs a constitutionally permissible "three-factor apportionment formula," it is "entitled to include" in the tax base of a unitary business "100% of [its] entire net income." App. 33a. Implicit in the Court's holding is the view that nothing in the constitution limits the manner in which the state defines "entire net income"—that it may

require add-backs, or disallow deductions, without regard to any resulting geographical distortions in the tax base.

Second, the Court held that "[d]enial of the W.P.T. deduction does not violate the commerce clause because it does not favor in-state over out-of-state economic activity." App. 34a. The Court did not address appellants' contention that, under the Court's construction of the CBT, taxpayers that engage in the exclusively out-of-state activity of oil production are subjected to a discriminatorily higher effective tax burden than are all other taxpayers, including independent marketers with whom the integrated companies directly compete in the New Jersey market.

Finally, the Court concluded that the disparate treatment of integrated companies and independent marketers does not violate the Equal Protection Clause. Integrated companies, the Court stated, "are denied a deduction because they produce crude oil and pay the W.P.T.," "while non-oil-producing petroleum marketers are not affected" because they "do not pay the W.P.T." App. 34a. It apparently made no difference that only those companies engaged in an exclusively out-of-state activity are denied a deduction for a substantial cost of producing or acquiring their goods. The Court further stated that producers, unlike independent marketers, had benefited "from the decontrol of crude oil prices." App. 34a. It did not explain why the measure of the producer's benefit may properly include not only the producer's but also the federal treasury's share of those higher prices.

THE QUESTION IS SUBSTANTIAL

I. THE CASE WARRANTS PLENARY REVIEW

This appeal squarely presents a fundamental question of state taxing power that this Court has not yet directly addressed: may a state, in taxing a multistate enterprise under the unitary business/formula appor-

tionment method, define "income" on a geographically tailored basis?

Under this Court's Due Process and Commerce Clause decisions, a state may tax only that portion of an interstate company's net income that is " 'reasonably attributable' to the business done there." *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942). The Court has been called upon frequently to measure against that standard two of the three key elements of state apportionment schemes—the fairness of the apportionment formula and the proper confines of the unitary business concept. *See Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 165-71 (1983). The question here is whether the third element—the definition of the taxable income of a unitary business—must, like the other two, be geographically neutral. This is the first case to reach this Court in which a state, while applying a standard three-factor apportionment formula, has introduced a material geographic bias into its determination of net income subject to apportionment.

New Jersey has achieved that result by denying a deduction for federal WPT payments—a cost borne only by producers of crude oil and measured by the incremental value at the wellhead of the oil they produce. No crude oil is produced in New Jersey. WPT liability is incurred only on account of business activities conducted entirely outside the state. When a state with no oil production taxes oil producers under a unitary business/formula apportionment method but denies a deduction for a substantial production cost, the effect is to gerrymander the preapportiomnent tax base, incorporating the out-of-state income while excluding the out-of-state costs incurred in generating that income.

The reach of state power to define the taxable income of a unitary business warrants this Court's plenary review. The New Jersey Supreme Court wrongly assumed that the federal constitution imposes no constraints at all on the exercise of that power. Under its theory, if a

state correctly determines the scope of a unitary business and applies an acceptable three-factor apportionment formula, nothing in the constitution prevents it from defining taxable income in any way it sees fit, even if the definition necessarily produces gross geographic distortions. That view eviscerates the fair apportionment requirement. It would be pointless to insist on a geographically neutral apportionment formula if the state were free to apply it to a geographically distorted income base.

In striking down New York's geographically discriminatory tax credit in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), this Court held that "[n]othing about the apportionment process releases the State from the constitutional restraints that limit the way in which it exercises its taxing power over the income within its jurisdiction." *Id.* at 398-99. A similar principle should apply here as well. The fairness of an apportionment formula should give a state no greater license to tamper in a geographically selective manner with a taxpayer's preapportionment net income base than to adjust in a geographically discriminatory manner its post-apportionment tax liability.

The deductibility of WPT payments, though only one possible manifestation of the issue presented here, is itself substantial. Since the tax was imposed in 1980, crude oil producers have paid more than $78 billion in WPT to the federal government.[9] As the New Jersey Supreme Court acknowledged, Congress assumed, when it enacted the WPT, that those payments "would generally be deductible for state income tax purposes." App. 34. The enormous amounts involved, however, are an inviting target for state tax authorities. As the record in this case illustrates, disallowing a deduction for WPT payments can have a dramatic effect on producers' state tax liabilities.

[9] *Budget of the United States Government, Fiscal Year 1988, Supplement*, Table 17, at 6c-34.

By denying a WPT deduction, New Jersey was able to increase the tax liability of these 11 appellants for taxable year 1980 alone (when crude oil price controls remained largely in effect and WPT payments were accordingly limited) by $8.3 million, an increment of 22 percent. App. 84a. In 1981, as WPT payments accelerated following the termination of price controls, the state tax repercussions were even more striking. For just the five appellants whose 1981 tax year is at issue, denial of the WPT deduction produced an aggregate increase in New Jersey tax liability of $12.5 million, an increment of 260 percent. *Id.* The impact on individual companies can be particularly egregious. In the case of Amerada Hess, for example, disallowance of the WPT deduction raised its New Jersey tax liability for 1981 from about $860,000 to $7.6 million, an increase of 775 percent. *Id.*

The full impact of the decision below, of course, is not limited to these appellants or to these two tax years. New Jersey itself recently estimated that, just for the years 1980 through 1984, the add-back provision, as construed below, would increase state tax receipts by $98 million.[10]

New Jersey is not alone. Six other states—either by express statutory provision or by ruling of state tax authorities—specifically disallow an income tax deduction for WPT payments.[11] Not surprisingly, all but one of those states, like New Jersey, have no crude oil production at all; the remaining state has only negligible production.[12]

[10] *New Jersey Budget Message and Taxpayers' Guide, Fiscal Year 1987-1988*, at 11 (Feb. 2, 1987).

[11] The states are Georgia, Iowa, Minnesota, New York, South Carolina, and Wisconsin. In addition, during the transition year of 1980, North Dakota imposed a ceiling of $1 million on a corporation's deduction of WPT payments. For years after 1980, the North Dakota statute permits a full deduction for WPT. The manner in which each of these states treats WPT payments is summarized at App. 85a-91a.

The overwhelming majority of states, moreover, use federal taxable income as the starting point for computing state corporate income tax, and many of those have add-back provisions similar to New Jersey's.[13] Whether such states are free to depart from the federal starting point, or from any other neutral starting point, in a geographically tailored manner has national implications well beyond the immediate scope of this litigation. If the New Jersey decision were upheld, for example, it could spawn attempts by tax authorities in the nonproducing states to withdraw deductions for state severance taxes imposed on oil, gas, and other mineral production, thereby increasing the nonproducing states' tax revenues at the sole expense of out-of-state business activities.

II. THE NEW JERSEY TAX, AS CONSTRUED AND APPLIED, IMPERMISSIBLY TAXES EXTRATERRITORIAL VALUES

It is fundamental that, "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State

[12] Only in New York is any crude oil produced, and its rate of production—in 1986 as well as in 1980 and 1981—averages only about 2,300 barrels per day, or less than three one-hundredths of one percent of the nation's total crude oil production of approximately 8.6 million barrels per day. The data are drawn from official publications of the Energy Information Administration, U.S. Department of Energy: *Petroleum Supply Annual 1986*, Vol. I, Table 9, at 31 (May 1987); *Petroleum Supply Annual 1981*, Vol. I, Table 9, at 43 (July 1982); *Energy Data Reports: Crude Petroleum, Petroleum Products, and Natural Gas Liquids: 1980*, Table 5, at 12 (December 1981).

[13] Of the 46 jurisdictions (including the District of Columbia) that impose a tax measured by corporate net income, 38 incorporate the Internal Revenue Code as the starting point for computing state taxable income. 1 Multistate Corp. Income Tax Guide (CCH) ¶¶ 125, 251. Many states disallow a deduction for, or require the add-back of, federal and state taxes measured by income or profit. *See id.* ¶¶ 97, 318, 321.

may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. v. Franchise Tax Board*, 463 U.S. at 164, *quoting ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). In the case of a multistate company that derives its income from more than one jurisdiction, a state may tax only that portion of the company's income that is fairly attributable to its in-state business activities. *Butler Bros. v. McColgan*, 315 U.S. at 506.

One constitutionally permissible way to determine the locally taxable portion of a company's multistate income is the "unitary business/formula apportionment method." *Container*, 463 U.S. at 165. It involves two steps. First, the state must compute the company's tax base subject to apportionment. That requires (i) "defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part" (*id.*), and (ii) determining the total amount of the unitary business's preapportionment net income. Second, the state "must then apply a formula apportioning the income . . . within and without the State," using "factors that actually reflect a reasonable sense of how income is generated." *Id.* at 169.

The unitary business/formula apportionment method does not permit a state to tax "extraterritorial values." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 442 (1980); *Butler Bros. v. McColgan*, 315 U.S. at 507. On the contrary, the method is permissible only insofar as it produces a "'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State.'" *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 223 (1980), *quoting Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978). In the words of Justice Holmes, "[t]he purpose is not . . . to open to taxation what is not within the State," but only to estimate "the true value of the things within it." *Wallace v. Hines*, 253 U.S. 66, 69 (1920).

The Court has synthesized these territorial limitations on state taxing power as part of a four-pronged test, developed principally in Commerce Clause cases but embodying Due Process standards as well. *See* 1 J. Hellerstein, *State Taxation* ¶ 4.8, at 123 (1983). To pass constitutional muster, a state tax, including one that employs the unitary business/formula apportionment method, (1) must be "applied to an activity with a substantial nexus with the taxing State," (2) must "be fairly apportioned," (3) must "not discriminate against interstate commerce," and (4) must be "fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

In applying the *Complete Auto* test, the Court is particularly vigilant to the dangers posed by geographically "tailored" state taxes that "single out interstate businesses and subject them to effects forbidden by the Commerce Clause." *Id.* at 288 n.15. Such tailoring "creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." *Id.* Accordingly, "[a] tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." *Id.*

As applied to vertically integrated oil companies, the New Jersey tax is geographically tailored. It singles out for uniquely disadvantageous treatment a substantial cost incurred on account of a business activity—crude oil production—that is performed only in states other than New Jersey. In its practical operation, the tax produces precisely the "forbidden effect" of which *Complete Auto* warned, violating all four prongs of the test. Putting to one side for a moment the question of discrimination, we address in this section the three territoriality prongs of the *Complete Auto* standard: fair apportionment, nexus, and fair relationship.

A. New Jersey's Construction of its Add-Back Provision Geographically Distorts the Tax Base of Crude Oil Producers and Results in an Unfairly Apportioned State Tax

The fairness of apportionment depends not only on the state's apportionment formula but also on the makeup of the tax base to which the formula is applied. The composition of the base turns on two considerations—the scope of the unitary business and the state's definition of taxable income. If a state defines income in a manner that incorporates out-of-state values disproportionately, even the fairest apportionment formula will necessarily yield a geographically biased and therefore improper result.

It follows that if, as here, a state imposes a tax based on net income—thereby allowing deductions from gross receipts—it cannot, consistent with constitutional limitations, tailor the allowable deductions to benefit local activities or burden foreign activities either (1) by permitting deductions for costs incurred only inside the state, or (2) by disallowing deductions for costs incurred only outside the state. Relatively minor departures from that principle might well fall "within the substantial margin of error inherent in any method of attributing income among the components of a unitary business." *Container*, 463 U.S. at 184. But where, as here, a discrete group of substantial taxpayers incurs a large out-of-pocket business expense on account of activities conducted exclusively outside the taxing jurisdiction, and where disallowing a deduction for that expense significantly augments both the taxpayers' tax liability and the state's tax collections, the tailoring of the income base should not be tolerated any more than other attempts to tax a disproportionate share of multistate income.

It is no answer to say, as New Jersey argued below (App. Div. Br. 21-23, 117-18) and as the state Supreme Court apparently assumed (App. 33a-34a), that deductions are solely a matter of legislative grace. In the first place, an allowance for the cost of producing goods is intrinsic to the kind of "net income" that may properly

be apportioned by a three-factor formula like New Jersey's. But even if a state were free to disallow all deductions and to tax a proportionate share of a multistate company's gross receipts, it would not follow that the state could permit or deny deductions from gross receipts without regard to constitutional restrictions. Once a state determines to allow deductions, it must do so on a geographically neutral basis. Were it otherwise, the fair apportionment standard could be evaded by the simple expedient of carving out deductions that effectively favor in-state or disfavor out-of-state activities.

A state could not, without exceeding its territorial taxing jurisdiction, single out an exclusively out-of-state business activity and require a taxpayer to double the income from that activity in computing its taxable net income. That would be "a mere effort to reach profits earned elsewhere under the guise of legitimate taxation." *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 283 (1924). The state should have no greater latitude, under the heading of legislative grace, to deny a deduction for half of the costs incurred on account of an out-of-state activity. Halving out-of-state deductions, no less than doubling out-of-state income, distorts the preapportionment tax base, violates the fair apportionment requirement, and "project[s] the taxing power of the state plainly beyond its borders." *Nashville, Chattanooga & St. Louis Ry. v. Browning*, 310 U.S. 362, 365 (1940).

This Court in *Westinghouse* rejected a similar attempt to invoke legislative grace. New York sought to justify its geographically discriminatory tax credit on the theory that it "forgives merely a portion of the tax that New York has jurisdiction to levy" (466 U.S. at 398)—in effect, because the state can tax the whole, it should be altogether free to tax a part. The Court held, however, that "it is not the provision of the credit that offends [constitutional limitations], but the fact that it is allowed on an impermissible basis, *i.e.*, the percentage of a

specific segment of the corporation's business that is conducted in New York." *Id.* at 406 n.12.

As in *Westinghouse*, the issue here is not whether New Jersey can grant or deny a deduction but whether it can do so "on an impermissible basis." *Id.* By disallowing a deduction for WPT costs incurred in connection with oil production activities performed exclusively outside the state, New Jersey defines its net income tax base in a geographically unbalanced fashion. The result, even after apportionment, is effectively to attribute to New Jersey a grossly disproportionate share of the multistate income of oil producers. The extraterritorial effect of New Jersey's add-back provision, moreover, like the discriminatory impact of New York's tax credit, tends to increase with the level of the disfavored out-of-state activity. 466 U.S. at 400-01 & n.9.

The unitary business approach permits New Jersey to tax a fair share of a taxpayer's "unitary stream of income," including income derived from the production of crude oil. *Exxon Corp. v. Department of Revenue*, 447 U.S. at 226. That income carries with it, however, a unitary stream of costs associated with the production of that income. A state cannot fairly tax the income while separating out and refusing to recognize costs associated only with out-of-state income-producing activities. That is simply another way of taxing more than a fair share of the unitary income.

B. The Effect of the Add-Back Provision Is to Impose on Crude Oil Production Activities with Which New Jersey Has No Nexus a Separate Tax Measured by Wellhead Values that Bear No Relationship to Activities Within New Jersey

The New Jersey add-back provision, as construed and applied, is indistinguishable in economic substance from a separately imposed New Jersey version of the federal WPT. The provision requires a producer to increase its preapportionment tax base by an amount equal to its

federal WPT liability, to "apportion" a share of that amount to New Jersey, and to pay tax on that share at the CBT rate of nine percent. The resulting increased tax liability is exactly the same as it would be if New Jersey simply imposed an "apportioned" WPT of its own at a rate equal to nine percent of the federal rate.[14]

The add-back provision, therefore, stands on the same constitutional footing as a state WPT. If New Jersey could not impose its own version of the federal WPT, neither may it accomplish the identical result in the form of an add-back to the CBT tax base.

Under the "nexus" and "fair relationship" prongs of the *Complete Auto* test, New Jersey is foreclosed from adopting a state WPT. The nexus and fair relationship criteria operate together to require a territorial link between a taxing state and both the operating incidence and the measure of the tax. The nexus standard is a "threshold requirement." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981). It forbids a state from levying "*any* tax" (*id.*; emphasis in original) on business activities with which it lacks a "minimal connection." *Exxon Corp. v. Department of Revenue*, 447 U.S. at 219; *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. at 436. The fair relationship standard, which is "closely connected" to the nexus requirement, "imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the [state's]

[14] Assume, for example, that a taxpayer's federal WPT liability for a particular year is $1 million and that its New Jersey apportionment fraction is 20 percent. Under the CBT as construed, the taxpayer must add $1 million to its preapportionment tax base, of which 20 percent (or $200,000) would be apportioned to New Jersey. The state would then apply its nine percent CBT rate to produce an increased tax liability of $18,000. Alternatively, if the state had simply adopted its own "apportioned" WPT at nine percent of the federal rate, the taxpayer's preapportionment New Jersey WPT liability would be equal to nine percent of the $1 million federal liability (or $90,000). New Jersey's apportioned share would be 20 percent of that amount (or $18,000). The effect is identical.

contact" with the taxpayer. *Commonwealth Edison*, 453 U.S. at 626 (emphasis in original).

When a state properly taxes the corporate net income of a unitary business, its nexus with any part of the unitary business empowers it to tax a fair portion of the entire "unitary stream of income." *Exxon*, 447 U.S. at 226. By contrast, when a state taxes a corporation's transactions, as opposed to its net income, the state must have a nexus with the transactions themselves, not just with the corporation. The rule is that "a state which controls the property and activities within its boundaries of a foreign corporation admited to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." *Connecticut General Life Insurance Co. v. Johnson*, 303 U.S. 77, 80-81 (1938).

Consistent with that principle, the Court held last Term that, when "the activity of wholesaling . . . [is] conducted wholly within [a particular state]," that state and "no other State has jurisdiction to tax" the gross proceeds derived from the activity. *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 107 S. Ct. 2810, 2822 (1987). Similarly, because mineral production occurs at a specific location, one state and only one state can have a nexus sufficient to tax it directly. *Commonwealth Edison*, 453 U.S. at 617. "'[T]he severance can occur in no other state' and 'no other state can tax the severance.'" *Id.*

That rule bars New Jersey from imposing a state WPT on the "removal" of a barrel of crude oil from out-of-state "premises." "Removal" of a barrel of oil consists of lifting the oil from the ground and transporting it away from the well. That event is indistinguishable for constitutional purposes from the "severance" of coal or other minerals. Indeed, at the time of its enactment, Congress repeatedly characterized the WPT as an "excise, or severance, tax." H.R. Conf. Rep. No. 817, *supra*, at 92; *accord* S. Rep. No. 394, *supra*, at 2, 29, 154; H.R. Rep. No. 304, *supra*, at 2; *General Explanation* at

3, 26. Removal, like severance, can take place at only one location. As with severance, only the state within which the removal occurs has sufficient nexus with the activity to tax it.

The fair relationship requirement reinforces the nexus standard. It precludes New Jersey from imposing a tax whose measure is a percentage of the value of the crude oil produced in another state. Such a tax would not be "in 'proper proportion' to [the taxpayer's] activities within the State" but instead would be tied improperly to its activities outside the state. *Commonwealth Edison*, 453 U.S. at 626. In such a case, "when the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce." *Id.* at 629. That was the basis of the holding in *American Trucking Ass'ns v. Scheiner*, 107 S. Ct. 2829 (1987), where the Court invalidated Pennsylvania's flat tax on truckers, in part because "the amount of . . . taxes owed by a trucker does not vary directly with miles traveled or with some other proxy for value obtained from the State." *Id.* at 2844.

As the New Jersey Supreme Court acknowledged, the measure of the WPT is the incremental value attributable to decontrol of each barrel of crude oil "at the point the oil was removed from the producing property." App. 6a. The increased value of crude oil at the point of its removal from the producing property bears a direct relationship to the producer's activities within the producing state. But it "bears no relationship to the [producer's] presence or activities" in New Jersey, *Commonwealth Edison*, 453 U.S. at 629, nor does it "vary directly with . . . [any] other proxy for value obtained from the State." *American Trucking Ass'ns*, 107 S. Ct. at 2844.

It is of no consequence that New Jersey's tax is "apportioned" by a three-factor formula. New Jersey is not free to impose any tax—whether apportioned or

not—whose operating incidence falls on property or transactions with which the state has no nexus, or whose measure is unrelated to the taxpayer's activities in the state. Where, as here, a state lacks jurisdiction to tax an activity, it cannot acquire such jurisdiction by applying an apportionment formula, the effect of which is simply to tax the activity at a reduced rate. As in *Westinghouse*, talk of apportionment in these circumstances "serves only to obscure the issue." 466 U.S. at 398.

Nor can New Jersey sidestep the nexus and fair relationship restrictions by accomplishing the prohibited results within the structure of an income tax. The "standard of permissibility of state taxation [is] based upon its actual effect rather than its legal terminology." *Complete Auto*, 430 U.S. at 281. The Court "decline[s] to attach any constitutional significance to . . . formal distinctions that lack economic substance." *Westinghouse*, 466 U.S. at 405. It may be proper for a state to include income from out-of-state oil production activities in the preapportionment tax base of a unitary business. *Exxon*, 447 U.S. at 225-27. But where, as here, a state manipulates its income tax by including the out-of-state income while excluding the associated out-of-state costs, thereby producing an effect that would be forbidden if achieved independently of the income tax, the result is no less forbidden merely because the state attaches an income tax label to it.

III. THE NEW JERSEY TAX, AS CONSTRUED AND APPLIED, UNLAWFULLY DISCRIMINATES AGAINST AN EXCLUSIVELY OUT-OF-STATE BUSINESS ACTIVITY

The Commerce Clause and the Equal Protection Clause serve complementary purposes: both effectively prohibit the imposition of unjustifiably discriminatory tax burdens on out-of-state business. *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981); *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 668 (1981). New Jersey's add-back provision violates both clauses. It imposes a discriminatorily higher effective tax burden on crude oil production activities—all of which are carried out in states other than New Jersey.

"[N]o State may discriminatorily tax the products manufactured or the business operations performed in any other State." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 337 (1977). That prohibition applies not only to "transactional taxes," such as the securities transfer tax in *Boston Stock Exchange*, but also to "taxes on general income." *Westinghouse*, 466 U.S. at 404. The New Jersey CBT, like the New York franchise tax in *Westinghouse*, "is a tax on the income of a business from its aggregated business transactions." *Id.* "It cannot be that a State can circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate—as is the franchise tax—rather than on individual transactions." *Id.*

Nor does it matter whether the additional burden is imposed in the form of a higher tax rate on out-of-state activities, a tax credit for in-state activities, or, as in this case, a disallowance of deductions for costs incurred only in connection with out-of-state activities. "The discriminatory economic effect . . . [is] identical." *Id.*

It is likewise inconsequential whether the statute is facially discriminatory or facially neutral. "[T]he Commerce Clause has a deeper meaning that may be implicated even though state provisions . . . do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." *American Trucking Ass'ns*, 107 S. Ct. at 2839. The relevant inquiry is whether "[a] tailored tax, *however accomplished*, . . . produces a forbidden effect on interstate commerce." *Complete Auto*, 430 U.S. at 289 n.15 (emphasis added).

The state itself conceded below that the "additional tax cost" borne by integrated oil companies under the

CBT "arises because [those companies] produce crude oil." App. Div. Br. at 121. The New Jersey Supreme Court similarly acknowledged that "[p]laintiffs are denied a deduction because they produce crude oil and pay the W.P.T." App. 34a. Those concessions are fatal under Commerce Clause jurisprudence. To impose a higher income tax burden on account of a taxpayer's out-of-state business activities is no different in principle from discriminatorily taxing those activities directly. *Westinghouse*, 466 U.S. at 404. Both results are forbidden.

The New Jersey Supreme Court mistakenly believed that the discriminatory tax burden is constitutionally inoffensive "because it does not favor in-state over out-of-state economic activity." App. 34a. It is true, of course, that the tax does not favor New Jersey crude oil production—there is none. In that respect, this case presents a slight twist on the questions considered in *Boston Stock Exchange* and *Westinghouse*. Those cases established that a state could not impose a heavier tax burden on out-of-state transactions than on the same transactions conducted within the state. The question here is whether a state may single out for special tax burdens a form of business activity that is conducted only in other jurisdictions.

Though the Court has never directly addressed that question, the "clear import of [its] Commerce Clause cases is that such discrimination is constitutionally impermissible." *Boston Stock Exchange*, 429 U.S. at 335. Allowing individual states to assess discriminatorily higher taxes on account of exclusively out-of-state business transactions would jeopardize "the free trade which the [Commerce] Clause protects." *Id.* at 329. If states with no mineral production, for example, could impose special tax burdens on mineral production activities, producing states would be equally free to impose retaliatory taxes designed to burden activities conducted only in non-producing states. The result—a web of discriminatory state tax levies—would discourage commerce among the states.

A company's opportunity to compete on even terms within a state, and therefore the likelihood that it will seek to do business there, is naturally reduced if it must bear unique tax burdens solely because of its business activities in another state. A tax like New Jersey's therefore "falls short of the substantially even-handed treatment demanded by the Commerce Clause." *Id.* at 332. Its "inevitable effect is to threaten the free movement of commerce by placing a financial barrier around" the taxing state. *American Trucking Ass'ns*, 107 S. Ct. at 2840.

Although there is no local oil production for New Jersey to favor, the CBT's discrimination does provide "a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). The integrated companies that produce oil outside New Jersey and market their products within New Jersey are denied a deduction for a substantial cost of their out-of-state production activities. By contrast, local independent marketers, with whom the integrated companies compete at the retail level in New Jersey, are permitted a full deduction for their cost of goods sold. As a consequence, an integrated company bears a higher effective tax cost than does a directly competing independent marketer.

The discriminatory effect can be shown by a simple illustration. Suppose that the cost of producing a barrel of domestic crude oil before WPT is 20, that the WPT cost is 10, that refining costs are 12, that the wholesale price of gasoline is 42, that marketing costs are 2, and that the price of gasoline at the pump is 46. To permit a comparison at the retail level, assume further that the integrated company earns no profit at the production or refining levels but earns the same profit as the independent marketer at the retail level. The following table shows that New Jersey's add-back provision operates to tax an integrated company more heavily than the independent marketer with which it competes:

Integrated Producer/Marketer	Independent Marketer
46 gross receipts	46 gross receipts
−42 cost of goods sold [15]	−42 cost of goods sold [15]
4 federal gross income	4 federal gross income
− 2 marketing expense deduction	− 2 marketing expense deduction
2 federal taxable income	2 federal taxable income
+10 N.J. WPT add-back	+ 0 N.J. WPT add-back (inapplicable)
12 N.J. tax base	2 N.J. tax base

Altering the assumptions to account for a profit at the production and refining stages does not negate the discriminatory effect of the add-back provision. The integrated company would still be subjected to a higher effective tax burden than its local independent competitor. Its taxable income, unlike the independent's, is inflated because of the state's refusal to recognize a substantial component of the integrated company's cost of goods sold.

That some members of the favored class of independent marketers may operate in interstate commerce does not insulate from Commerce Clause attack the discrimination against out-of-state crude oil production. The Commerce Clause prohibits the imposition of a discriminatory tax burden on out-of-state "business operations," *Boston Stock Exchange*, 429 U.S. at 337, even if the burden falls only on a segment of interstate operators. In *American Trucking Ass'ns*, for example, the Court struck down Pennsylvania's discriminatory axle tax even though "*some* out-of-state carriers . . . pay the axle tax

[15] A company's "cost of goods sold"—including the acquisition cost of finished products and costs "incident to and necessary for production or manufacturing operations or processes" (Treas. Reg. § 1.471-11(b)(1))—is subtracted from gross receipts to determine federal gross income. Treas. Reg. § 1.61-3(a). The integrated company's cost of goods sold in the illustration includes pre-WPT production costs of 20, WPT costs of 10, and refining costs of 12, for a total of 42. The independent marketer's cost of goods sold consists of the wholesale gasoline acquisition cost of 42.

at a *lower* per-mile rate than some Pennsylvania based carriers." 107 S. Ct. at 2842 (emphasis added). *Accord Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 39-42 (1980) (invalidating a Florida statute that discriminated against some but not all out-of-state bank holding companies); *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 348-54 (1977) (striking down a North Carolina statute that discriminated against some but not all out-of-state apple growers).

Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), on which the New Jersey Supreme Court relied (App. 34a), is of no help to the state. The Court there upheld against Commerce Clause challenge a Maryland statute prohibiting crude oil producers and refiners from operating retail service stations within the state. As the Court emphasized, however, Maryland's prohibition, unlike New Jersey's add-back provision, neither "raised the cost of doing business for out-of-state dealers" nor gave "instate independent dealers . . . [a] competitive advantage over out-of-state dealers." *Id.* at 126. Moreover, the power to exclude a company from doing business within a state does not imply the power, asserted by New Jersey here, to admit the company on the condition that it submit to a discriminatory tax burden that would otherwise offend either the Commerce Clause, *Western Union Telegraph Co. v. Kansas*, 216 U.S. 1, 47-48 (1910), *Pullman Co. v. Kansas*, 216 U.S. 56 (1910), or the Equal Protection Clause. *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 875 (1985); *Western & Southern Life Insurance*, 451 U.S. at 667-68.

Finally, New Jersey cannot justify its discriminatory application of the add-back provision on the ground that "nonproducing marketers did not benefit, as did plaintiffs, from the decontrol of crude oil prices, but had to purchase their crude oil at the higher decontrolled prices." App. 34a. To the extent that an integrated company has benefited from decontrol, the benefit is reflected in its

overall net income, a fair portion of which is properly subject to taxation by New Jersey under the CBT *without* the add-back provision. WPT payments represent the *federal treasury's* share of higher crude oil prices. From the producer's standpoint, WPT liability is a burden, not a benefit. New Jersey's discriminatory attempt to tax both the increased net income *and* the WPT tax cost resulting from decontrol is not a rational way to equalize the tax treatment of producers and nonproducers. On the contrary, it unjustifiably puts producers at a material economic disadvantage.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted,

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SEPTEMBER 1987

87 453

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

AMERADA HESS CORPORATION *et al.*,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

On Appeal from the Supreme Court of New Jersey

APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

SUPREME COURT OF NEW JERSEY

SEPTEMBER TERM, 1986

Docket Nos. 25,264-25,277

AMERADA HESS CORPORATION, ATLANTIC RICHFIELD COMPANY, CONOCO INC., CITIES SERVICE COMPANY, EXXON CORPORATION, PHILLIPS PETROLEUM COMPANY, CHEVRON U.S.A. INC., MOBIL OIL CORPORATION, UNION OIL COMPANY OF CALIFORNIA, GULF OIL CORPORATION, SHELL OIL COMPANY, DIAMOND SHAMROCK CORPORATION, TENNECO OIL COMPANY, AND TEXACO, INC.,
Plaintiffs-Respondents,

v.

DIRECTOR, DIVISION OF TAXATION,
Defendant-Appellant.

Argued November 18, 1986—Decided June 22, 1987

The opinion of the court was delivered by

KING, P.J.A.D. (temporarily assigned).

This case concerns the interpretation of seven words in the New Jersey Corporation Business Tax (C.B.T.), *N.J.S.A.* 54:10A-1 to -40. These seven words, "on or measured by profits or income," determine whether the Federal Windfall Profit Tax on Domestic Crude Oil (W.P.T.), 26 *U.S.C.A.* § 4986 to § 4998, is excludable in computing the oil company plaintiffs' net income taxable under our C.B.T.

Entire net income is the base on which New Jersey's C.B.T. is assessed. The entire net income base for the C.B.T. is similar but not identical to the tax base used for federal corporate income purposes. Adjusted gross income for federal tax purposes is calculated by deducting certain federal and State taxes paid by the corporation. New Jersey law specifically requires that certain amounts paid in federal taxes be added back into the tax base for calculation of the C.B.T. This is called the "add-back" provision. Thus, the base for federal corporate income tax is not identical to the "net income" base on which the C.B.T. is assessed. This difference is at the core of the dispute before us.

The fourteen plaintiffs in this case are vertically integrated oil companies that engage in every aspect of the crude oil business, including exploration, development, refining, manufacturing and marketing. None of the plaintiffs has oil producing properties in New Jersey, but all conduct other aspects of their business within this State. In this case the oil companies urge that they can exclude the amount they paid in the Federal Windfall Profits Tax on Domestic Oil (W.P.T.), I.R.C. §§ 4986 to 4998, from the calculation of their net taxable income for purposes of the New Jersey's Corporation Business Tax (C.B.T.), *N.J.S.A.* 54:10A-1 to -40. The Director of the Division of Taxation disagrees and argues that these payments are not excludable.

The C.B.T. is a fairly allocated franchise or excise tax levied on business corporations for the privilege of "doing business, employing or owning capital or property, or maintaining an office" in New Jersey. *N.J.S.A.* 54:10A-2, 10A-8. The tax basis for the C.B.T. is "entire net income" which is defined in *N.J.S.A.* 54:10-4(k) as

> total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through

> a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed *prima facie* to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax.

However, subsection (k) also provides that

> (2) Entire net income shall be determined without the exclusion, deduction or credit of:
>
> * * * *
>
> (C) Taxes paid or accrued to the United States *on or measured by profits or income* * * *.
>
> [*N.J.S.A.* 54:10A-4(k) (2) (C) (emphasis supplied).]

The crucial issue in this case is whether the W.P.T. is a tax "on or measured by profits or income" within the intent of *N.J.S.A.* 54:10A-4(k)(2)(C). If the W.P.T. is a tax "on or measured by profits or income" within the intent of the C.B.T., the Director was correct in disallowing its exclusion from the net income base for C.B.T. purposes. At the time the net income provision was added to the corporation business tax in 1958, *L.* 1958, *c.* 63, the W.P.T. did not exist. *F.W. Woolworth Co. v. Director, Div. of Taxation*, 45 *N.J.* 466, 473 (1965). Therefore the drafters and adopters of this section of the C.B.T. could not have harbored any specific legislative intent on includability of the W.P.T., which became effective in 1980, in the tax base.

The federal "windfall profits tax on domestic crude oil," I.R.C. §§ 4986-4998 (1980), was imposed after President Carter announced that he would gradually decontrol domestic crude oil prices beginning in June 1979. The price controls originated with President Nixon's Wage and Price Controls in August 1971. The Energy

Policy Act made them mandatory through May 1977 and gave the President discretion to remove them until 1981. *See* H.R. Rep. No. 304 96th Cong. 1st Sess. 1980 U.S. Code Cong. & Ad. News 1980, 410, 591. 42 *U.S.C.A.* § 6201, and scattered sections to § 6392. Because of the shortage of crude oil for American markets caused by supply cut-backs by Iran and other international producers, President Carter decided to exercise his authority and decontrol prices during 1979. The background of the W.P.T. was described by Justice Powell in *United States v. Ptasynski*, 462 *U.S.* 74, 76-77, 103 *S.Ct.* 2239, 2240, 2241, 76 *L.Ed.*2d 427 (1983).

> In 1979, President Carter announced a program to remove price controls from domestic oil by September 30, 1981. [See H.R. Rep. No. 96-304, 5 (1979) reprinted in 1980 U.S. Cong. & Ad. News 593]. By eliminating price controls, the President sought to encourage exploration for new oil and to increase production of old oil from marginal economic operations. See H.R. Doc. No. 96-107, 2 (1979). He recognized, however, that deregulating oil prices would produce substantial gains (referred to as "windfalls) [*sic*] for some producers. The price of oil on the world market had risen markedly, and it was anticipated that deregulating the price of oil already in production would allow domestic producers to receive prices far in excess of their initial estimates. See *ibid.* Accordingly, the President proposed that Congress place an excise tax on the additional revenue resulting from decontrol.
>
> Congress responded by enacting the Crude Oil Windfall Profit Tax Act of 1980, 94 Stat. 229, 26 *U.S.C.* § 4986 *et seq.* (1976 ed., Supp V) [I.R.C. §§ 4986 to 4998]. The Act divides domestic crude oil into three tiers and establishes an adjusted base price and tax rate for each tier. See §§ 1986, 1989, and 4991. The base prices generally reflect the selling price of particular categories of oil under price controls, and the tax rates vary according to the vintages and types of oil included within each tier. See Joint Committee on Taxation, General Explanation of the Crude Oil Windfall Profit Tax Act of 1980, 96th Cong., 26-36 (Comm. Print 1981). The House Report explained that the Act is "designed to impose relatively high tax rates where production cannot be expected to respond very much to further increases in price and relatively low tax rates on oil whose production is likely to be responsive to price." H.R. Rep. No. 96-304, at 7 [reprinted in 1980 U.S. Cong. & Ad. News 594]; see S. Rep. 96-394, p. 6 (1979) [reprinted in 1980 U.S. Cong. & Ad. News 417]

Thus, the windfall tax was imposed on the incremental income attributable to decontrol of domestic prices. This incremental income was created by the cartel-generated international oil shortages, which had driven up international oil prices. It was attributable to world market conditions designed to limit supply and to raise prices; it was not generated by any infusions of capital or the expenditure of creative entrepreneurial energy by the domestic oil producers. Thus, there emerged the concept of taxing "windfall profits," or profits not earned by traditional economic activity as known to our economy. In mid-1979 just before the beginning of President Carter's decontrol of oil prices, the controlled price of "old" oil was $5.86 a barrel, the controlled price of "new" oil was $13.06 a barrel, and the uncontrolled world price was approaching $20 per barrel. The world price eventually reached $30 per barrel.

The W.P.T. differed from the regular federal corporate income tax as it was imposed on production at the wellhead rather than on these integrated domestic producers' overall net profits or income ultimately calculated from gross sales and net profits as measured at the pump.

This method of taxation creates the dispute at hand—whether the W.P.T. is "on or measured by profits or income" or is another species of tax. As noted, the basic measure of the windfall profit was the difference between the uncontrolled and controlled price of a barrel of crude oil at the point the oil was removed from the producing property. The actual tax rate varied from 30% to 70%, I.R.C. § 4987, and was determined by the length of time the property had been productive. Because oil from newly-productive property was taxed at a lower rate than oil from older wells, tax differentials motivated exploration for and discovery of new oil-producing properties by the domestic companies, thus reducing dependency on foreign oil.

A net income limitation (N.I.L.) also was enacted by Congress to insure that the W.P.T. would not be imposed on a company when the costs of production exceeded the income from a particular property. I.R.C. § 4988. The N.I.L. placed a ceiling on the taxable windfall profit equal to 90% of the net income from a barrel of oil, netting barrels sold at a profit with barrels selling at a loss. I.R.C. § 4988(b). The W.P.T. was imposed on the lesser of the windfall profit or 90% of the net income per barrel. All fourteen respondent oil companies used the N.I.L. to calculate their W.P.T. liability for the taxable years under scrutiny, 1980 and 1981. The use of the N.I.L. resulted in a total savings of $1,685,465,293 to these taxpayers over the tax that would have applied if the wellhead assessment had stood alone without the N.I.L. The W.P.T. is a deduction for federal income tax purposes. I.R.C. §§ 164(a)(4), 4988(b). The W.P.T. remains effective until December 1990 or until $227.3 billion is realized, whichever is later. I.R.C. § 4990.

In the spring of 1983 the fourteen respondent oil companies filed complaints in the New Jersey Tax Court challenging either assessments for deficiencies or denial of refund claims in respect of all of their 1980, and in

five instances their 1981, C.B.T. returns. The Director of the Division of Taxation in each case had denied deduction of the W.P.T. from the C.B.T. "net income" base. For each denial, the Director had relied on the position of the New York State Department of Taxation and Finance, which ruled in May 1982 that the W.P.T. was a measure of profits and not excludable for purposes of determining income under the New York Corporate Franchise Tax, which is similar to the C.B.T. *TSI-M* 82 (227) *CCH State Tax Rptr.* (N.Y.) ¶ 9-909. The New York administrative ruling, set out in the margin in full, concluded: "As the windfall profit tax is measured by profit the modification is required and the tax must be added to entire net income." [1]

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[1] Memorandum *TSB-M*-82(22)C.

Technical Services Bureau, Taxpayer Services Division, Department of Taxation and Finance, Corporation Tax, July 12, 1982.

Opinion of Counsel

Deductibility of Federal Windfall Profits Tax under Article 9-A

May 28, 1982

William A. Craven, Director

Audit Division

Your memorandum of November 14, 1980 to Saul Heckelman requested an opinion as to whether the windfall profit tax imposed by Chapter 45 of the Internal Revenue Code of 1954, as amended, is a modification increasing the entire net income base for the Article 9-A franchise tax of subject taxpayers.

Section 208.9 of the Tax Law provides in pertinent part that:

"(b) Entire net income shall be determined without the exclusion, deduction or credit of:

(1) the amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations,

* * * *

(3) taxes on or measured by profits or income paid or accrued to the United States, . . ."

Section 4986(a) of the Internal Revenue Code provides that: [2]

The oil companies and the Director filed cross-motions for summary judgment in the Tax Court. Judge Conley granted summary judgments for the Director. *Amerada Hess v. Director, Div. of Taxation*, 7 *N.J. Tax* 51 (1984) (*Amerada I*). He concluded that our "legislature surely perceived the windfall profits tax to be a tax on profits or income and felt no need to amend the corporation business tax for that reason." *Id.* at 56. In holding that

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"An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period."

The tax is also characterized in the conference report as a severance tax.

Section 4987(a) thereof states that the tax is an applicable percentage of windfall profit; windfall profit is defined in section 4988(a) thereof as follows:

"General Rule. For purposes of this chapter, the term 'windfall profit' means the excess of the removal price of the barrel of crude oil over the sum of—

(1) the adjusted base price of such barrel, and

(2) the amount of the severance tax adjustment with respect to such barrel provided by section 4996(c)."

Section 4988 thereof places a net income limitation on windfall profit.

Section 164(a)(5) of the Internal Revenue Code, as amended by Public Law 96-223, allows a deduction from federal adjusted gross income for the amount of windfall profit tax; other deductible taxes allowed under section 164 include those levied on real property, personal property, foreign, state and local income taxes, and general sales taxes.

The modification required by section 208.9(b)(3) of the Tax Law is not dependent on whether the federal tax is an excise tax or property tax or income tax in nature. The modification is required where the tax is levied on or measured by profit or income. As the windfall profit tax is measured by profit, the modification is required and the tax must be added to entire net income.

PAUL B. COBURN

Deputy Commissioner and Counsel

the sum of the W.P.T. must be included in the "net income" base, Judge Conley accepted the Director's contention that the Legislature did not have to amend the C.B.T. after the W.P.T. was enacted because the W.P.T. already fell within the "add-back" provision of *N.J.S.A.* 54:10A-4(k)(2)(C). He rejected the oil companies' contention that because the Legislature did not amend the C.B.T., the W.P.T. did not fall within the "add-back" provisions and that excludability was intended.

The oil companies moved for reconsideration of Judge Conley's decision. Judge Lario, who was assigned to hear these motions because Judge Conley had resigned from the bench to return to private practice, refused to "substitute . . . [his] interpretation of the Legislature's intent," for that of Judge Conley. *Amerada Hess Corp. v. Director, Div. of Taxation*, 7 *N.J. Tax* 275, 282 (1985) (*Amerada II*).

The Appellate Division reversed the Tax Court and held that the W.P.T. was "a federal excise tax imposed upon the difference between world prices and the adjusted base price." *Amerada Hess Corp. v. Director, Div. of Taxation*, 208 *N.J.Super.* 201, 203 (1986) (*Amerada III*), and that in calculating the net income base for the purposes of C.B.T., the oil companies could exclude the W.P.T. The Appellate Division reasoned that since the W.P.T. was imposed as each barrel of crude oil is brought to the surface, "its consequences are in no way dependent upon the realization of gain or income, and no provision is made for a refund or credit should the barrel not be sold," *id.* at 203-04, and held that "the W.P.T. is not a tax on or measured by profits or income within the meaning of *N.J.S.A.* 54:10A-4(k)(2)(C)." The Appellate Division did not think that the 90% N.I.L. materially influenced the analysis because the N.I.L. was calculated on "properties" of the oil producer and not on "overall profitability." *Ibid.*

For the reasons given below, we reverse the judgment of the Appellate Division and reinstate the judgment of the Tax Court.

I

We conclude that the Tax Court properly applied the principle of probable legislative intent in deciding that the phrase in *N.J.S.A.* 54:10-4(k)(2)(C), "taxes paid or accrued to the United States on or measured by profits or income," included the W.P.T. The principle of probable intent applies where the legislative body, when adopting a statute, could not have contemplated a specific situation. In such a case we have said:

> Generally, a court's duty in construing a statute is to determine the intent of the Legislature. In cases such as this, where it is clear that the drafters of a statute did not consider or even contemplate a specific situation, this Court had adopted as an established rule of statutory construction the policy of interpreting the statute "consonant with the probable intent of the draftsman 'had he anticipated the situation at hand'." *J.C. Chap. Prop. Owner's etc. Assoc. v. City Council*, 55 *N.J.* 86, 101 (1969) (quoting *Dvorkin v. Dover Tp.*, 29 *N.J.* 303, 315 (1959)); *Safeway Trails, Inc. v. Furman*, 41 *N.J.* 467 appeal dismissed and *cert.* den., 379 *U.S.* 14, 85 *S.Ct.* 144, 13 *L.Ed.*2d 84 (1964). Such an interpretation will not "turn on literalisms, technisms or the so-called rules of interpretation; [rather] it will justly turn on the breadth of the objectives of the legislation and the commonsense of the situation." *J.C. Chap. Prop. Owner's*, 55 *N.J.* at 100. [*AMN, Inc. v. South Brunswick Township Rent Leveling Bd.*, 93 *N.J.* 518, 525 (1983).]

One commentator has noted, "Legislative purpose may also be a valuable guide to decision in cases where the effect of a statute on the situation at hand is unclear

. . . because the situation was unforeseen at the time when the act was passed, . . ." 2A C. Sands, *Sutherland Statutory Construction*, § 45.09 (4th ed. 1984) (hereinafter *Sutherland*). The "common sense" of this situation, as we perceive it, and as the Tax Court pointed out, *Amerada I*, 7 *N.J.Tax* at 56, is that if the Legislature had anticipated the enactment of the W.P.T., it would have been concerned over the possible effect of a new federal tax on profits on the State's revenues. The deductibility of the W.P.T. would shrink the State's tax base by the amount of the taxes paid. We think the Legislature probably would have viewed the W.P.T. as a tax on the "profits" and 'income" of oil companies, thereby avoiding a revenue loss. Thus, no amendment to the C.B.T. would have been necessary to embrace the W.P.T. within the inclusive basis of *N.J.S.A.* 54:10A-4(k)(2)(C).

We reject the oil companies' contention that the doctrine of legislative intent has no application because the meaning of the statute is unclear and all doubts should be resolved in favor of the taxpayer. *See Fedders Fin. Corp. v. Director, Div. of Taxation*, 96 *N.J.* 376, 386 (1984); *see also White v. United States*, 305 *U.S.* 281, 292, 59 *S.Ct.* 179, 184, 83 *L.Ed.* 172 (1938), where Justice Stone said

> We are not impressed by the argument that, as the question here decided is doubtful, all doubts should be resolved in favor of the taxpayer. It is the function and duty of the courts to resolve doubts. We know of no reason why that function should be abdicated in a tax case more than in any other where the rights of suiters turn on the construction of a statute and it is our duty to decide what the construction fairly should be.

Here we do not think the statute is unclear or of doubtful meaning. Moreover, where the taxpayer seeks exemp-

tion or deduction urging exclusion from the scope of the taxing statute, "the probable legislative intent is one of inclusion and exemptions are to be construed narrowly," *Fedders*, 96 *N.J.* at 386; *Boys' Club of Clifton, Inc. v. Township of Jefferson*, 72 *N.J.* 389, 398 (1977). The reason for this rule of construction is plain. Taxes "are demanded and received in order for government to function." *Bloomfield v. Academy of Medicine of N.J.*, 47 *N.J.* 358, 363 (1966). Exemptions "from taxation represent a departure and consequently they are most strongly construed against those claiming exemption." *Id.* As the Tax Court pointed out, "the issue here is whether the "plaintiffs may exclude or deduct the W.P.T." *Amerada I*, 7 *N.J.Tax* at 53. The Director's ruling that the taxpayers here did not meet that burden was reasonable in the circumstance.

We also reject the oil companies' contention that the issue involves solely the "add-back" of the W.P.T. to income or the inclusion of the W.P.T. in income. The scheme of the C.B.T. supports the Tax Court's characterization of the issue as one involving an exclusion or deduction. "Entire net income" for purposes of the preliminary computation of the C.B.T.'s income base is "federal taxable income" before the net operating loss deduction and special deductions, *e.g.*, the dividends received by corporations' deduction of *I.R.C.* § 243. *N.J.S.A.* 54:10A-4(k). As shown by some of the plaintiffs' 1980 and 1981 federal income tax returns, the W.P.T. was claimed as a deduction on line 17 in arriving at federal taxable income. But *N.J.S.A.* 54:10A-4(k)(2) provides that certain exclusions, deductions and credits are not allowed to the taxpayer in calculating entire net income under *N.J.S.A.* 54:10A-4(k)(2)(C). As noted, one disallowed deduction is for "taxes or accrued to the United States on or measured by profits from income." Thus the correct characterization of the issue is whether the W.P.T. is a proper exclusion or deduction.

The oil companies' reliance on *Fedders* is unsuccessful for another reason. In *Fedders*, Justice Schrieber noted that in addition to the rule concerning the strict construction of taxing statutes "when interpretation of a taxing statute is in doubt," 96 *N.J.* at 385, there is a second principle: a court must "follow the clear import of statutory language." *Id.* at 384-85. The Tax Court correctly concluded that the "clear import" of the W.P.T. fit the language of the taxing statute—"taxes on or measured by profits or income"—as these words are commonly understood.

Another fundamental principal of statutory construction applies here. Statutes must be read as a whole, giving effect where possible to every word. *Brown v. Brown*, 86 *N.J.* 565, 577 (1981); *Fabbi v. Division of Employment Sec.*, 35 *N.J.* 601, 606 (1961). When *N.J.S.A.* 54:10A(4(k), including subsection (k)(2)(C), is read in its entirety, we see that when the Legislature wanted to define the word "income" in terms of the federal income tax law, it did so in clear terms. The statute states that "entire net income" prior to the modifications in subsection (2)(A) through (2)(F) "shall be deemed . . . to be . . . the taxable income . . . which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax." The language of subsection (k)(2)(C) is completely different. The disallowed federal taxes are not described as income taxes, or net income taxes, or taxes based on income as measured for federal income tax purposes, but simply as federal taxes "on or measured by profits or income," a more inclusive concept. Nowhere in the C.B.T. do we find any intent to disallow only federal taxes similar or identical to the federal income tax.

The distinction between the preliminary computation of entire net income under the C.B.T. (which is clearly referenced to the federal income tax) and the modifica-

tions to that preliminary computation, which differs from the federal income tax, was explained by that Tax Court in *International Flavors and Fragrances, Inc. v. Director Div. of Taxation*, 5 *N.J.Tax* 617 (1983), aff'd, 7 *N.J. Tax* 652 (App.Div.1984), aff'd, 102 *N.J.* 210 (1986), when it said

> While the starting point for determination of entire net income under the act is taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report for Federal income tax purposes, the Corporation Business Tax deviates from the federal tax by providing its own inclusions and exclusions from the tax base. *N.J.S.A.* 54:10A-4(k). Only at the initial point is it indicated that the Legislature intended that federal standards were to be controlling. [5 *N.J.Tax* at 624.]

The Tax Court in the case before us agreed with this conclusion. *Amerada I*, 7 *N.J.Tax* at 57.

Finally on this point, we reject the oil companies' contention that legislative inaction or silence in respect of the enactment of the W.P.T. supports its contention on non-inclusion. We find the doctrine of probable legislative intent a more reliable guide than the so-called doctrine of legislative inaction. "Legislative inaction has been called a 'weak reed upon which to lean' and a 'poor beacon to follow' in construing a statute." 2A *Sutherland* § 49.10. We see no common-sense reason why our Legislature would not have intended the W.P.T. to be included within the statutory disallowance for tax "on or measured by profits or income." We adopt Judge Conley's words in the Tax Court in this case when he said: "I am entirely satisfied from the ordinary meaning of these words and from the public perception of the purpose of the Windfall Profit Tax, that the legislators would have been reassured that no amendment of the statutory language was

needed to protect the State's revenue source." 7 *N.J.Tax* at 56.

We find Justice Scalia's discussion of the use of legislative inaction as a tool of interpretation in *Johnson v. Transportation Agency, Santa Clara County*, 480 *U.S.* ——, 107 *S.Ct.* 1442, 94 *L.Ed.*2d 615 (1987) (dissenting opinion) of interest and apt.

> The majority's response to this criticism of [*Steelworkers v. Weber*, 443 *U.S.* 193, 99 *S.Ct.* 2721, 61 *L.Ed.* 2d 480 (1979)], . . . asserts that, since "Congress has not amended the statute to reject our construction, . . . we . . . may assume that our interpretation was correct." This assumption, which frequently haunts our opinions, should be put to rest. It is based, to begin with, on the patently false premise that the correctness of statutory construction is to be measured by what the current Congress desires, rather than by what the law as enacted meant. To make matters worse, it assays the current Congress' desires *with respect to the particular provision in isolation*, rather than (the way the provision was originally enacted) as part of total legislative package containing many *quids pro quo*.
>
> * * * *
>
> But even accepting the flawed premise that the intent of the current Congress, with respect to the provision in isolation, is determinative, one must ignore rudimentary principles of political science to draw any conclusions regarding that intent from the *failure* to enact legislation. The "complicated check on legislation," The Federalist No. 62, p. 378 (C. Rossiter ed. 1961), crected by our Constitution creates an inertia that makes it impossible to assert with any degree of assurance that congressional failure to act represents (1) approval of the status quo, as opposed to (2) inability to agree upon how to alter

the status quo, (3) unawareness of the status quo, (4) indifference to the status quo, or even (5) political cowardice. It is interesting to speculate on how the principle that congressional inaction proves judicial correctness would apply to another issue in the civil rights field, the liability of municipal corporations under § 1983. In 1961, we held that that statute did not reach municipalities. See *Monroe v. Pape*, 365 *U.S.* 167, 187 [81 *S.Ct.* 473, 484, 5 *L.Ed.* 2d 492] (1961). Congress took no action to overturn our decision, but we ourselves did, in *Monell v. New York City Dept. of Social Services*, 436 *U.S.* 658, 663 [98 *S.Ct.* 2018, 2021-22, 56 *L.Ed.*2d 611] (1978). On the majority's logic, *Monell* was wrongly decided, since Congress' seventeen years of silence established that *Monroe* had not "misperceived the political will," and one could therefore "assume that [*Monroe's*] interpretation was correct." On the other hand, nine years have now gone by since *Monell*, and Congress *again* has not amended § 1983. Should we now "assume that [*Monell's*] interpretation was correct"? Rather, I think we should admit that vindication by congressional inaction is a canard. [480 *U.S.* at —— - ——, 107 *S.Ct.* at 1472-73, 94 *L.Ed.*2d at 656-57.]

For these reasons, we hold that the Tax Court correctly reasoned that under the doctrines of probable legislative intent and common-sense plain meaning the oil companies may not deduct the W.P.T. in calculating net income for C.P.T. purposes.

II

The characterization by the Director of the W.P.T. as a tax measured by "income" or "profits" is not an unusual or extreme conclusion. It is consistent with the conclusions reached by others and with oil industry economics.

A California decision construing the analogous phrase in the California corporation franchise tax, "taxes on or according to or measured by income or profits," concluded that the phrase included taxes on or measured by gross income. *MCA, Inc. v. Franchise Tax Bd.*, 115 *Cal.App.*3d 185, 171 *Cal.Rptr.* 242, (Ct.App.1981) (taxes paid to foreign governments on gross film rents and gross record royalties not deductible). "The fact that such rents and royalties also constituted MCA's gross receipts [did] not make the taxes any less taxes measured by gross income." *Id.* at 192, 171 *Cal.Rptr.* at 246. As noted, the New York State Department of Taxation and Finance construed the identical phrase in the New York corporation franchise tax law against deductibility finding it a tax "on or measured by profits or income" whether labelled an excise tax, a property tax, or an income tax. *Supra* at ——. The Attorney General of South Carolina has concluded that the W.P.T. is a tax with respect to income that may not be deducted in computing income for South Carolina tax purposes. Opinion of the Attorney General, March 10, 1982, noted at *CCH State Tax Rptr.* (S.C.) ¶ 200-088.

The base and measure of the W.P.T. plainly fit the usual definitions of "income" and "profits." The W.P.T. is based on windfall profit. I.R.C. § 4986(a). The windfall profit is the difference between the removal or selling price and the adjusted base price plus severance tax adjudgment. I.R.C. § 4988(a). The adjusted base price is essentially the price that could have been obtained for the oil under price controls, adjusted for inflation. The windfall profit cannot be equated with the market value of oil; it is a net amount, not simply the sales price, as in the case of federal transactional excise taxes.

The average adjusted base price, or actual costs, if more, were deductible by the oil companies from the sale price or fair market value of their crude oil to determine the measure and base of the W.P.T. As explained by the

State's economic expert, Dr. Vasquez, the existence of "income" for tax purposes does not require the deduction of all true economic costs. There are many provisions that are more arbitrary than the adjusted base price, having "little if any connection to economic cost." I.R.C. § 63(c) and § 1(f) (personal deduction); I.R.C. § 616(a) (expensing exploration and development costs); I.R.C. § 613(a) (excess of percentage over cost depletion); I.R.C. § 168 (the timing of depreciation deductions for accelerated cost recovery). The record before us and the opinion of Professor Deakin, another State's economic expert, show that the deduction of the adjusted base price permitted the recovery of all allowable costs for those oil companies that revealed such costs. Dr. Deakin's report, which stands essentially unchallenged in the record, stated:

> 21. The base price deduction, on average, more than compensates oil producers for costs incurred to produce the oil subject to the tax. The severance tax adjustment allows a deduction for the additional severance tax that arises as a result of the increase in the removal price of the oil as a result of price decontrol. This adjustment permits a dollar for dollar recovery of those incremental costs. Under price controls, base prices were supposed to permit economic recovery of crude oil. This means that the crude oil production operations must obtain at least a normal profit under price controls. If they did not, then producers would be expected to shut down operations and invest their money in other activities, all of which would be contrary to energy policy at the time. The prices allowed under price control should, therefore, permit a producer to recover production costs plus a reasonable return on production. To the extent that the prices in the price control system carried over to the Windfall Profit Tax as adjusted base prices, deduction of the adjusted base prices from revenue may be viewed as a deduction in lieu of itemizing production costs and normal profits. The Windfall Profit Tax itself is not included in the deductions to compute federal taxable income. To include either item in calculations of the tax base creates circularity.
>
> 22. Using the data available from published financial reports of these companies, it appears that the adjusted base prices exceeded average production costs (exclusive of Windfall Profit Tax) for all of the companies in this litigation. For example, in 1980, national adjusted base prices for the Windfall Profit ranged from \$13.06 per barrel to \$18.44 per barrel depending on the tier and the quarter. A survey of the annual reports of the companies showed that for 1980 the approximate average cost to produce an equivalent barrel of oil, exclusive of the Windfall Profit Tax but including depreciation, depletion and amortization, exploration costs, dry holes (when reported) and other costs to produce oil and gas ranged from \$4.50 to \$8.45 per barrel. Hence, on average, in 1980, these companies' costs were compensated for through the base price mechanism. In 1981, national adjusted base prices ranged from \$14.47 to \$20.81 per barrel, depending on the tier and the quarter in which the oil was produced. In 1981, the range of costs for the plaintiffs was between \$7.49 and \$13.48 per barrel. This analysis is based on costs reported according to generally accepted accounting principles and is subject to all the limitations that apply to such reports. Nonetheless, as a practical matter, the adjusted base price deduction appears to have the effect of allowing producers compensation for their average actual costs of production as those costs are measured under generally accepted accounting principles. Moreover, the difference between the adjusted base prices and the aver-

age costs to produce is sufficiently large to allow compensation for some additional costs before the adjusted base price deduction would fail, on average, to compensate oil producers for their production costs. Indeed, the net income limitation provisions allow for those cases where the adjusted base price does not adequately cover the costs to produce oil.

Thus the tax is based on profits.

As well stated by a California appellate court

> The [W.P.T.] statute imposes an excise tax *on profit* and furnishes the mechanics by which the profit and the tax are to be calculated. Had Congress desired to impose a tax on removal, other language would have been used. [*Crocker Nat'l Bank v. McFarland Energy, Inc.*, 140 *Cal.App.*3d 6, 189 *Cal.Rptr.* 302, 304 (Ct. App. 1983) (emphasis added).]

See also Lewis v. Reagan, 516 F. Supp. 548, 553 (D.D.C. 1981) ("The Windfall Profit Tax taxes the increased *income* that will accrue to the owners of domestic oil properties after the limiting of price controls.") (emphasis supplied); *United States v. Ptasynski, supra*, 462 *U.S.* at 103, 103 *S.Ct.* at 2255, 76 *L.Ed.*2d at 436 ("[Congress] perceived that the decontrol legislation would result—in certain circumstances—in profits essentially unrelated to the objective of the program, *and concluded that these profits should be taxed*.") (emphasis added).

Many sections in the W.P.T. are intended to limit its tax base, not just to income but to that increment of income representing the excess of the uncontrolled price of oil over the controlled price. Further as Professor Deakin points out, we must assume that the controlled price permitted the recovery of the producer's costs or that a particular unprofitable field would have been abandoned by a prudent producer before decontrol. The adjusted base price equates roughly with the controlled price of oil in 1979. I.R.C. § 4989(c). The inflation adjustment is also cost motivated. I.R.C. § 4989(b). The severance tax adjustment, I.R.C. § 4988(a) and I.R.C. § 4996(c), insures that the base and measure of the W.P.T. excludes one of the major costs associated with decontrol—State severance taxes imposed on the incremental value of crude oil resulting from decontrol.

Congress' intention that the base of the W.P.T. allow a producer to recover production costs before taxation is most persuasively shown by the net income limitation (NIL) provision. I.R.C. § 4988. The purpose of the provision was to "prevent the tax from burdening high cost properties . . . where the net income per barrel is less than the windfall profit." (House Report at 2; Senate Report at 29). (H.R. Rep. No. 96-304, 96th Cong. 1st Sess. 1980 U.S. Code Cong. & Ad. News 589; S. Rep. No. 96-394, 96th Cong. 1st Sess. 29 (1979) 1980 U.S. Code Cong. & Ad. News 438, 439).

Computation of the net income per barrel is based upon the computations of gross income and taxable income used to determine percentage depletion for federal income tax purposes. I.R.C. § 4988(b)(3). Gross income from a property is determined under *Treas. Reg.* § 1.613-3, reprinted in *CCH Federal Tax Rptr.* 1987 Vol. 5, ¶ 3557C. This regulation helps determine gross income from the oil and gas well for I.R.C. § 613(a) and (c)(1) when the oil is not sold but is refined or converted by the same oil company. The regulation is used to determine gross income for purposes of computing percentage depletion—either the selling price in the immediate vicinity of the well, or, if the oil is not sold on the premises, the "representative market or field price before conversion or transportation." The latter price equates generally with the removal price under the W.P.T. when oil is not sold on the premises. Compare I.R.C. § 4988 (b)(3) with I.R.C. § 4988(c)(3), both referenced to

I.R.C. § 613. Taxable income is the gross income from the property less the expenses set forth in the regulation, including operating expenses, certain sales costs, administrative and financial overhead, depreciation, taxes deductible under § 162 or § 164, (except the W.P.T.), losses, and exploration and development expenditures. I.R.C. § 4988(b)(3); *Treas. Reg.* § 1.613-3. These expenses are a producer's actual expenses incurred on or allocable to a particular property. The process of calculation of the net income or taxable income when the N.I.L. is employed is described in Shurtz, *"The Windfall Profit Tax—Poor Tax Policy? Poor Energy Policy?"* 34 *U. Miami L. Rev.* 1115, 1142-43 (1980).

> The net income or taxable income under section 4988(b) is calculated as it is under section 613(a), relating to percentage depletion, but with certain modifications. Taxable income from the property equals gross income less allowable deductions. Deductible items include operating expenses, certain selling expenses, administrative and financial overhead, depreciation, deductible taxes, losses sustained, intangible drilling and development costs, exploration and development expenditures, and other similar expenditures. For purposes of section 4988(b), this taxable income is calculated as in section 613 but without deductions for intangible drilling and development costs or the windfall profit tax. In lieu of these deductions, the Act allows an imputed cost depletion deduction, the calculation of which depends on whether the producer uses percentage or cost depletion. If a producer actually capitalizes intangible drilling costs for income tax purposes, he may reduce his taxable income from the property by the amount of the deduction under section 611 (either as cost depletion or as depreciation). If the producer used percentage depletion for the property for all periods during which he owned an economic interest in it, the producer's taxable income is reduced for cost depletion, which would have been allowable if all intangible drilling costs incurred by the taxpayer on the property had been capitalized and taken into account in computing the depletion. In contrast to the provisions of the House and Senate Reports, the Act allows the producer to treat qualified tertiary injectant costs as if they had been capitalized and recovered through cost depletion.

Despite the contrary suggestion by certain of the oil companies, cost depletion is allowed in determining net income. See I.R.C. § 4988(b)(3)(C). The W.P.T. itself is not allowed as a deduction in calculating the W.P.T. base. This is not surprising since the purpose of the net income computation is to determine the tax base for the W.P.T. To allow a deduction in the tax base for the tax itself would be circular. Under I.R.C. § 4988(b)(3)(C) such costs are deductible over time because they are included in the capitalized cost of the property for W.P.T. cost depletion purposes.

Hess mischaracterizes the N.I.L. in claiming that it is only a limitation on and does not define the base of the W.P.T. When the N.I.L. is invoked, the base for imposing the W.P.T. becomes 90% of the net income per barrel. As stated by Texaco's tax attorney, the W.P.T. is imposed on the "smaller" of the windfall profit or the net income per barrel. Alleged infrequent use of the N.I.L. during 1980 and 1981 as proof that it does not limit the tax base to net income, as urged by the Atlantic oil companies, is not persuasive. During the "phased decontrol" period, 1980, the N.I.L. substantially reduced the oil companies' W.P.T. liability. In 1980 all but one of the plaintiff oil companies computed the tax based upon the net income from the property on between 14% and about 73% of their respective production. The effect was less pronounced in 1981. The dollar reduction in tax liability for the various oil companies resulting

from use of the N.I.L. ranged from 21% to 45% in 1980 to 3% to 13% in 1981 and totaled $1,685,465,293 for these two years. The reason the N.I.L. was not used more frequently was that often the windfall profit was smaller than the net income base. In these cases, the deduction for the adjusted base price plus incremental severance taxes exceeded the oil companies' actual costs.

As the Director's expert Vasquez points out, the absence of absolute economic symmetry in a tax scheme is no ground to dismiss it as irrational, illogical or misdescribed. He stated:

> The plaintiffs argue that income implies a "gain," which in turn implies that the tax base is gross income less allowable deductions for cost. The plaintiffs argue that the Windfall Profit Tax is based solely on the value of oil above some threshold without reference to the cost of producing the oil.
>
> This assertion is wrong; the Windfall Profit Tax does in fact recognize cost. The higher of the adjusted base price or cost computed for the net income limitation is allowed as a deduction in computing income for purpose of the Windfall Profit Tax. The adjusted base price does not equal economic costs. However, under the current Federal individual and corporate income tax structures, the measure of income includes allowances for costs that are often just as arbitrary as allowing a deduction for the "adjusted base price." If the arbitrariness of deductions from income is grounds for declaring that the resulting net amount is not income for tax purposes, then the base of the corporate and individual income taxes fails to qualify as income on the same grounds.
>
> One example of the arbitrariness of allowable deductions is the zero bracket amount allowed individuals. The zero bracket amount allows a deduction

> from gross income that is not based on any notion of cost or outlay. Independent of the income spent on medical expenses, interest, state and local taxes, union dues or other allowable itemized deductions, a taxpayer is simply allowed to deduct an amount that was legislated by Congress. Similar to the adjusted base price, the zero bracket amount will increase with inflation starting in 1985. Despite this legislated deduction, the individual income tax is viewed by most analysts as a tax based on income.

We agree.

Under ordinary dictionary definitions of "income," *i.e.*, all that comes in without regard to expenditures, the windfall profit clearly constitutes "income." The windfall profit also meets a more restrictive definition, *i.e.*, gross receipts less costs of goods sold, because the deduction for the adjusted base price plus severance tax adjustments permits more than the deduction of getting the oil out of the ground (producer's cost of goods), and in cases where the windfall profit exceeds 90% of the net income per barrel, the tax base becomes the lower amount, 90% of net income. Even if the term "profits" is given its most restrictive meaning, *i.e.*, revenue less expenses, the base of the W.P.T. is within the definition because the N.I.L. permits the deduction of all reasonably allocable expenses before arriving at net income. Because the tax is reasonably geared to establishing realized or realizable gain at an easily-measured stage, we reject the oil companies' contention that there must be immediate realization from a sale or exchange, a netting of ultimate gains or losses of an integrated company, a computation of an integrated entrepreneur's income or profit, or an annual or other periodic computation. The Director's decision that the oil companies experienced a realization of income or profit upon extraction of oil at the well and is amply supported in this record and by common sense. It is very unlikely, if not realistically

impossible, given the structure of the W.P.T. and the market conditions under which it was imposed, that any integrated oil company producer would both pay the W.P.T. and suffer a net loss at the end of an annual period, and this was hardly the experience of the parties before us.

III

There is adequate support in the record for the conclusion that the windfall profit tax qualifies as a tax on "income" or "profit" in the economic sense. The Director's expert, Dr. Vasquez, reported that of the three necessary ingredients postulated by plaintiffs—realization, cost recovery, and time—only one, deduction for costs, was necessary to satisfy the economic definition of income. He also concluded that no existing federal tax would qualify as a tax on income if deductions for true economic costs were required as a strict test. Under the W.P.T. the deduction for the greater of the adjusted base price or actual costs under the N.I.L. is as accurate a representation of true costs as many of the deductions in the I.R.C. for other income tax purposes. For example, he explained that in the case of oil producers, the deduction for the excess of percentage over cost depletion, I.R.C. § 613(a), bears no relation to actual cost. Dr. Vasquez also observed that since economic income may be computed on "an accrual basis" without a sale, contemporaneous realization is not required. He concluded that while the deduction for the adjusted base price under the W.P.T. may be an arbitrary allowance for costs, it is no more arbitrary than the zero bracket amount, the expensing of exploration and development costs, and percentage depletion. He noted that the N.I.L. computation recognized costs in an economic sense—thus, the base and measure of the W.P.T., the lesser of the windfall profit per barrel or 90% of the net income per barrel, satisfied economic concepts of income as well as does the tax base for the conventional federal individual and corporate income tax satisfied such concepts.

In the Tax Court, the oil companies made no attempt to counter these opinions of the State's economists. They simply argued that the court should adopt the two other theories of income, realization and a flow of money accruing within a fixed temporal period. Where there is a rational basis in the record for the economic conclusion inferred from the facts, an appellate court may affirm. We cannot in any sense say that the factual conclusion of the Director and the decision of the Tax Court that the tax in fact was levied here on "profit" and "income" was arbitrary, capricious, unreasonable, or unsupported by substantial credible evidence in the record as a whole. *See Henry v. Rahway State Prison*, 81 *N.J.* 571, 579-80 (1980).

Among the early federal income tax decisions relied upon by the plaintiffs is *Eisner v. Macomber*, 252 *U.S.* 189, 40 *S.Ct.* 189, 64 *L.Ed.* 521 (1920). In determining that a common stock dividend paid on common stock was not income, the Court defined income as "'the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets. . . ." 252 *U.S.* at 207, 40 *S.Ct.* at 193. The Court went on to state that income must be "something of exchangeable value . . . severed from the capital . . . and . . . received or drawn by the recipient (the taxpayer), for his separate use, benefit and disposal. . . ." *Ibid.* The receipt of a stock dividend did not permit the taxpayer to withdraw any part of his capital; rather, his investment remained "subject to the risks of the enterprise." *Id.* at 208, 40 *S.Ct.* at 194. The Court concluded that a taxpayer does not realize income if, "every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money . . . still remains . . . subject to business risks which may result in wiping out the entire investment." *Id.* at 211, 40 *S.Ct.* at 195.

The lifting of crude oil meets even the strict requirements of the *Macomber* definition of realization, including the requirement of conversion. When lifted to the surface and captured, the oil has been "severed" from the capital. It is no longer part of a deposit of unknown quantity several thousand feet down in the earth. As Professor Deakins noted, it has a fixed exchangeable value tied to a posted price system. The producer receives it for his separate use and benefit. The business risks have fundamentally changed; the producer's entire investment is unlikely to be wiped out. There has been a "conversion of capital assets" from an indeterminable underground deposit to a fungible, readily marketable product. (Deakin Report at 21). The *Macomber* requirement has since been modified. *See United States v. Kirby Lumber Co.*, 284 *U.S.* 1, 52 *S.Ct.* 4, 76 *L.Ed.* 131 (1931) (Gain to corporation by redeeming bonds at a price less than par value).

Lifting crude oil completes the production process and therefore constitutes "the completion of a transaction." *Helvering v. Bruun*, 309 *U.S.* 461, 469, 60 *S.Ct.* 631, 634, 84 *L.Ed.* 864, 869 (1940). While there may be no sale, the value of the oil is plainly "ascertainable." Posted prices

> control the amounts at which crude oil passes from hand to hand in the fields to which they relate. They are a bonafide competitive price, not subject to manipulation or rigging, for the reason, aside from others, that their maintenance is effectively policed by state regulatory bodies and also by state and Federal taxing authorities in connection with enforcement of taxing statutes. [*Skelly Oil Co. v. Commissioner of Taxation*, 269 *Minn.* 351, 131 *N.W.*2d 632, 636 (1964).]

The fact that the posted price may fall subsequent to the lifting of the oil or that some barrels may be lost following severance from the lease is irrelevant. The fact that some of the plaintiffs subsequently lose barrels of oil and are not entitled to refunds of W.P.T. in respect of such losses does not impugn the fact that oil production income is realized when the oil is lifted. According to this record these "downstream" losses are minimal, in fact less than .2% of production plus purchases of crude oil. The posted price fixes the value of the oil at the point of lifting. Later events do not detract from this fact (Deakin Report at 20).

Following production or lifting of crude oil, plaintiffs either sell the oil to third parties, exchange it with third parties, or transfer it to the refining division of their integrated businesses. For example, as a percentage of crude oil produced by the eleven Atlantic plaintiffs plus crude oil acquired after lifting from other companies, the Atlantic plaintiffs sold at the crude oil stage without refinement between 0% and 53% of their total barrels and exchanged between 0% and 84%. Every Atlantic plaintiff either sold or exchanged some amount of oil at the crude oil stage before refinement.

IV

The fact that the W.P.T. has been labeled or termed an excise tax (I.R.C. § 4986(a)) does not prevent it from being on or measured by income or profits. There are other federal excise taxes measured by income in Subtitle D—Miscellaneous Excise Taxes. I.R.C. § 4981 (excise tax on the undistributed taxable income of real estate investment trusts); I.R.C. § 4940 (excise tax on investment income of private foundations).

State taxes that are denominated franchise or excise taxes are often measured by income. The New Jersey corporation business tax itself is a franchise or excise tax measured in part by income. *Cities Service Co. v. Director, Div. of Taxation*, 5 *N.J.Tax* 257, 271 (1983). The savings institution tax, *N.J.S.A.* 54:10D-1 to -10D-

18, is stated to be an excise tax measured by net income. *N.J.S.A.* 54:10D-3; *see also Commissioner of Rev. v. Massachusetts Mutual Life Ins. Co.*, 384 *Mass.* 607, 428 *N.E.*2d 297 (1981).

Thus, despite Texaco's arguments to the contrary, the fact that the W.P.T. may be denominated an excise tax (I.R.C. § 4986) does not determine whether it falls within the statutory disallowance for taxes "on or measured by profits or income." The label appended to the tax is not conclusive. Indeed, it has been suggested that "income" for purposes of an excise tax may differ from "income" as conceived under an income tax. *Commissioner of Revenue v. Massachusetts Mut. Life Ins. Co., supra*, 428 *N.E.*2d at 301 (Massachusetts excise tax measured by gross investment income could include in the measure of the tax items such as imputed home office rent which would not be income in the traditional sense); *Polaroid Corp. v. Commissioner of Revenue*, 393 *Mass.* 490, 472 *N.E.*2d 259, 264 n.10 (1984). Under such a view, the fact that the W.P.T. is an excise tax supports rather than detracts from the conclusion that it is "on or measured by profits or income." *See Crocker Nat'l Bank v. McFarland Energy Inc.*, 140 *Cal.App.*3d 6, 189 *Cal.Rptr.* 302 (Ct. App.1983), where the court stated

> The [W.P.T.] statute imposes an excise tax on profit and furnishes the mechanics by which the profit and the tax are to be calculated. Had Congress desired to impose a tax on removal, other language would have been used. [*Id.* at 10, 189 *Cal.Rptr.* at 304.]

In dismissing a taxpayer's suit under the Anti-Injunction Act, the court in *Lewis v. Reagan, supra*, 516 *F.Supp.* at 552, noted that "The W.P.T. taxes the increased income that will accrue to the owners of domestic oil properties after the lifting of price controls."

As the Tax Court properly stated, "The precise issue in this litigation is whether the crude oil windfall profit

tax is a tax 'on or measured by profits or income' *within the intent of the Corporation Business Tax Act.*" *Amerada I*, 7 *N.J.Tax* at 54. Many federal legislators viewed the W.P.T. as exacted on profits. The House and Senate Committee Reports both stated that the tax will reduce the profits of the oil companies. *House Report* at 2, 1980 U.S.Code Cong. & Ad.News 589, 590; *Senate Report* at 2, 1980 U.S.Code Cong. & Ad.News 413, 414. Expressing their additional views, Senators Ribicoff, Nelson, Moynihan, Baucus, Bradley, Packwood, Roth, Danforth, Chafee, Heinz and Durenberger stated concerning the increases in world oil prices:

> Here, we believe, there is a huge "windfall" to producers; presumably, this oil was profitable at $6 and will be over 400 percent more profitable after decontrol. . . .
>
> Oil companies do not need to keep all the windfall profits from prior investments as an incentive to explain exploration and production, as long as they are assured of higher prices. According to their third quarter reports, cash flow is not a problem for most oil companies. Even under the committee bill, decontrol will add $374 billion to oil producers' net revenues over the next ten years [*Senate Report* at 132-33, 1980 U.S.Cong. & Ad.News 538.]

In like vein, Senator Matsunaga stated

> While producers enjoy the windfall profits that will accrue because of cartel pricing, it is only fair that they should share this windfall profit with the Nation. [*Senate Report* at 162, 1980 U.S.Cong. & Ad.News 565.]

Numerous other Congressmen viewed the W.P.T. as a tax on profits. *See* 125 *Cong.Rec.* H17141 (Rep. Lederer); 125 *Cong.Rec.* H17141 (Rep. Shannon); 125 *Cong.Rec.* H17151 (Rep. Ullman); 125 *Cong.Rec.* H17152 (Rep. Harris).

IV

We reject the balance of the oil companies' additional contentions on this appeal for these reasons.

1. Hess asserts as its main argument that because the statutory disallowance for taxes on income and profits was added to the New York franchise tax to cover the federal income and federal excess profits tax, the disallowance in the C.B.T. can apply only to those taxes or to taxes that Hess equates with those taxes that in its view do not include the W.P.T. But Hess' argument overlooks the basic point that the reach of a statute is not limited to situations existing at the time of its adoption. *Radiofone Corp. of N.J. v. Director, Div. of Taxation*, 4 *N.J. Tax* 420, 430 (1982). As noted, the New York State Department of Taxation and Finance is in agreement with our view. Its official position is to disallow a deduction for the W.P.T. in determining entire net income under the New York analogue to New Jersey's CBT. *Supra.* at n.1. We agree with the Attorney General's observation that ultimately "the whole excursion into New York legislative history is beside the point." The language in the New Jersey C.B.T.—"taxes on or measured by profits or income"—is on its face sufficiently broad to include taxes other than the federal income tax and federal excess profits tax. Resort to New York legislative history is not helpful and surely not determinative.

2. The Atlantic plaintiffs urge that since the Director would not permit separate accounting in determining plaintiffs' entire net income, he cannot deny a deduction for the W.P.T. which they contend is measured by segmenting income or profit, that is, the income or profits from plaintiffs' exploration and production divisions. These plaintiffs assert that such an asymmetrical construction of *N.J.S.A.* 54:10A-4(k) is not permissible because *N.J.S.A.* 54:10A-4, -5, and -6 should be construed "in *pari materia*," citing *American Tel. & Tel. Co. v.*

Director, Div. of Taxation, 4 *N.J.Tax* 638 (1982), aff'd, 194 *N.J.Super.* 168 (App.Div.1984). We disagree. That case had nothing to do with a deduction claimed in arriving at entire net income. The court was there concerned with the inclusion of income items in subsection 4 and the inclusion of gross receipt items in subsection 6. Where, as here, the issue is the allowability of a claimed deduction and not the inclusion or exclusion of income from the tax base, there is not logical compulsion requiring a symmetrical computation with the receipts' fraction.

3. The Atlantic plaintiffs assert that the addition of the W.P.T. to the net income base of the C.B.T. results in a distortion between the base, which they contend now includes an item of unearned income, and the receipts factor of the apportionment fraction, which includes only earned receipts. Denial of a deduction for the W.P.T. may augment the entire net income by the amount disallowed but this does not add unrealized income to the base. Whether a deduction is allowed or disallowed in arriving at entire net income does not change the nature of plaintiffs' receipts, which are still realized. We find no precedent or justification for plaintiffs' contention that the disallowance provision applies only to federal taxes directed at the same income base as the C.B.T.

4. We reject the contention that denial of a deduction for the W.P.T. violates the Due Process Clause. Plaintiffs are concededly unitary businesses. New Jersey is entitled to include in their respective tax bases 100% of each companies' entire net income. The reduction of that base to reflect constitutionally taxable income attributable to New Jersey activities is accomplished by the three-factor apportionment formula. *Silent Hoist & Crane v. Director, Div. of Taxation*, 100 *N.J.* 1, 7 (1985). As the Tax Court properly noted, "[T]he question here is only whether plaintiffs may claim a deduction from their net income tax base, not whether there

should be an addition to that portion of the tax base." *Amerada I*, 7 *N.J.Tax* at 57.

Denial of the W.P.T. deduction does not violate the commerce clause because it does not favor in-state over out-of-state economic activity. *See Commonwealth Edison Co. v. Montana*, 453 *U.S.* 609, 101 *S.Ct.* 2946, 69 *L.Ed.*2d 884 (1981); *Exxon Corp. v. Governor of Maryland*, 437 *U.S.* 117, 98 *S.Ct.* 2207, 57 *L.Ed.*2d 91 (1978). Because the denial of a deduction for the W.P.T. was not based on the interstate nature of plaintiffs' businesses and did not burden out-of-state companies, consumers, or transactions while favoring in-state activities, the disallowance did not discriminate against interstate commerce. Nor does the disallowance overcome the strong presumption of constitutionality confronting the plaintiffs' equal-protection-clause attack. *Lehnhausen v. Lakeshore Auto Parts Co.*, 410 *U.S.* 356, 359, 93 *S.Ct.* 1001, 1003, 35 *L.Ed.*2d 351, 354-355 (1973). Plaintiffs are denied a deduction because they produce crude oil and pay the W.P.T. The fact that they are disallowed the deduction while non-oil-producing petroleum marketers are not affected is because non-oil-producing marketers do not pay the W.P.T. Moreover, the nonproducing marketers did not benefit, as did plaintiffs, from the decontrol of crude oil prices, but had to purchase their crude oil at the higher decontrolled prices.

5. Finally, we reject the contention that denial of a deduction violates the supremacy clause by thwarting federal energy and revenue policies. There is no substantial connection between disallowance of the deduction and the accomplishment of these policies. Although the legislative history suggests an assumption that the tax would generally be deductible for state income tax purposes, there is no shred of evidence that such treatment was a mandatory or integral part of the over-all federal policies motivating passage of the legislation. We find no readily apparently conflict with any federal

law or any expressed or clearly implied federal policy. *See Armstrong v. Director, Div. of Taxation*, 5 *N.J. Tax* 117, 131 (1983), aff'd *o.b.*, 6 *N.J.Tax* 447 (App. Div.1984). We will not presume such a conflict.

We reverse the judgment of the Appellate Division and reinstate the judgment of the Tax Court.

For reversal—Justices CLIFFORD, HANDLER, O'HERN, STEIN and KING—5.

For affirmance—None.

APPENDIX B

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION

A-2795-84T7, A-2796-84T7
A-2797-84T7, A-2799-84T7
A-2800-84T7, A-2812-84T7
A-2809-84T7, A-2814-84T7
A-2813-84T7, A-2818-84T7
A-2816-84T7, A-2819-84T7
A-2832-84T7, A-2846-84T7

AMERADA HESS CORPORATION, ATLANTIC RICHFIELD COMPANY, CONOCO INC., CITIES SERVICE COMPANY, EXXON CORPORATION, PHILLIPS PETROLEUM COMPANY, CHEVRON U.S.A. INC., MOBIL OIL CORPORATION, UNION OIL COMPANY OF CALIFORNIA, GULF OIL CORPORATION, SHELL OIL COMPANY, DIAMOND SHAMROCK CORPORATION, TENNECO OIL COMPANY, AND TEXACO, INC.,
Plaintiffs-Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Defendant-Respondent.

Argued January 7, 1986—Decided February 7, 1986

The opinion of the court was delivered by,

ANTELL, P.J.A.D.

Plaintiffs, consisting of fourteen domestic oil producers, appeal from a determination of the Tax Court requiring taxes paid to the federal government under the Crude Oil Windfall Profit Tax Act of 1980, 26 *U.S.C.A.* §§ 4986-4998, (hereinafter referred to as "WPT") to be included as taxable income under the New Jersey Corporation Business Tax Act, *N.J.S.A.* 54:10A-1 *et seq.* (hereinafter referred to as "CBT"). The opinion of the Tax Court is reported at 7 *N.J.Tax* 51 (Tax Ct.1984). The essential factual and statutory framework is not in dispute.

The CBT was amended in 1958 to provide for the payment of taxes on "entire net income." This is defined by *N.J.S.A.* 54:10A-4(k) as follows:

> (k) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax; provided, however, that in the determination of such entire net income,
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> * * * *
>
> (2) Entire net income shall be determined without the exclusion, deduction or credit of:
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> * * * *
>
> (C) Taxes paid or accrued to the United States on or measured by profits or income. . . .

This appeal focuses on the proviso that entire net income shall be determined "without the exclusion, deduc-

tion or credit of: * * * [t]axes paid or accrued to the United States on or measured by profits or income . . .," referred to as the "add-back" provision. As the Tax Court observed, the precise issue is whether the WPT tax is a tax on or measured by profits or income within the meaning of the foregoing enactment.

The WPT was enacted by Congress following the removal of controls upon the price of domestically produced crude oil. The effect of decontrol was to enable the oil producers to receive prices paid on the world market in competition with foreign producers. As respondent acknowledges, the WPT is a federal excise tax imposed upon the difference between world prices and the adjusted base price, which is the controlled price after allowance for inflation and severance taxes. The so-called windfall profit lies in the difference between the two prices. The tax is imposed on each barrel of crude oil when it is brought to the surface and "removed from the premises," 26 *U.S.C.A.* § 4986(a), regardless of how much the producer later receives for the barrel, whether it is ever resold on the market and even if it is lost or destroyed. Its consequences are in no way dependent upon the realization of gain or income, and no provision is made for a refund or credit should the barrel not be sold. However, the WPT provides for a "net income limitation" which confines the tax base to the lesser of the windfall profit per barrel or 90% of the net income attributable to the barrel. 26 *U.S.C.A.* § 4988(b)(1). The net income attributable to the barrel is calculated by dividing the taxable income realized by the particular oil property by the number of barrels produced. 26 *U.S.C.A.* § 4988(b)(2).

As one commentator has noted, the term "windfall profit" in the title of the Act is, in part, a misnomer. Shurtz, "The Windfall Profit Tax-Poor Tax Policy? Poor Energy Policy?" 34 *U.Miami L.Rev.* 1115, 1117 (1980). The structure of the Act is designed to increase the pro-

duction of domestic oil and to promote energy independence for the United States. *Id.* at 1156. Thus, oil exploration is encouraged by imposing varying rates of taxation ranging from 30% to 70% on different "tiers" of oil. 26 *U.S.C.A.* § 4987(b). To greatly simplify, tier-one oil, upon which the highest tax rate is imposed, comes from properties which were producing before 1973; tier-two oil comes from properties which began production after 1972; tier-three oil includes oil produced through very expensive tertiary recovery techniques and oil discovered after January 1979. *See* 26 *U.S.C.A.* § 4991; Robison, "The Misnamed Tax: The Crude Oil Windfall Profits Tax of 1980," 84 *Dickinson L.Rev.* 589, 592-595 (1980). Under the Act, certain newly produced oil, such as that taken from a property in Alaska outside one of the existing Prudhoe Bay properties, is exempt. 26 *U.S.C.A.* §§ 4991(b) and 4994(e); Shurtz, *supra*, at 1156. It is evident, therefore, that the amount of tax actually realized from each barrel of crude removed from the premises is significantly affected by factors unrelated to income or profit.

Because the WPT is payable without regard to the profitability of the oil producers' overall business activities plaintiffs maintain that it is not a tax on or measured by profits or income and should therefore be deducted from entire net income in determining the tax base under the CBT.

The Tax Court decided that the WPT fell within the add-back provision of the CBT on the sole ground that by failing to amend the CBT following passage of the WPT the state legislature demonstrated its understanding that no further legislative action was needed to clarify its intent that the WPT *was not* deductible from entire net income. This rationale is flawed by the fact that it arbitrarily presupposes the very fact in question. The court could just as easily have reached a contrary result by assuming that the legislature did not amend

the CBT in recognition that the CBT as written sufficiently manifested its intent that the WPT *was* deductible from entire net income. Thus, it has been observed, "[i]nsofar as legislative intent is concerned inaction demonstrates nothing more than that subsequent legislatures failed to act." *Masse v. Public Employees Retirem. Sys.*, 87 *N.J.* 252, 264 (1981).

Our treatment of this issue begins with the rule that "when interpretation of a taxing provision is in doubt, and there is no legislative history that dispels that doubt, the court should construe the statute in favor of the taxpayer." *Fedders Financial Corp. v. Taxation Div. Dir.*, 96 *N.J.* 376, 385 (1984). See also *Kingsley v. Hawthorne Fabrics, Inc.*, 41 *N.J.* 521, 528-529 (1964) wherein the Supreme Court quoted approvingly the following language from *Gould v. Gould*, 245 *U.S.* 151, 153, 38 *S.Ct.* 53, 62 *L.Ed.* 211, 213 (1917):

> In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen.

In the definition of "entire net income" as a tax base for the CBT we discern from the use of such terms as "total net income," "gain" and "profit" an intent to tax the difference between revenues and expenses received and incurred in the overall conduct of business. Indeed, the statute itself specifies that entire net income

> shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax. . . .

For purposes of federal income taxation the WPT is declared a deductible expense, like state and local taxes, 26 *U.S.C.A.* § 164(a)(5), rather than as one of the nondeductible taxes enumerated at 26 *U.S.C.A.* § 275, typically federal income, excess profits and penalty excise taxes. As H.R.Rep. No. 96-304 (June 22, 1979) states at 600: "the Windfall Profit Tax is a deductible business expense under the income tax."

In our view the purpose of the add-back provision is to preserve undiluted for state taxation the same tax base upon which federal income taxes were computed. That it should not be read to include legitimate business expenses so as to create tax liabilities in spite of overall losses is suggested by the philosophy implicit in the report of the New Jersey Tax Policy Committee, *Non-Property Taxes in a Fair and Equitable Tax System* (1972). This document was prepared by a distinguished committee appointed by Governor Cahill in 1970 and comprehensively reviews New Jersey's system of public financing. One of the questions which it explored was whether and to what extent New Jersey should rely on the net worth or net income components of the CBT. In recommending an increase in the tax rate on the net income component the committee stated:

> In reaching these conclusions, we have proceeded on the premise that, in general, the net income measure of the corporate tax commends itself, *because it imposes the levy in accordance with actual profits earned, whereas the net worth tax, which is essentially a levy measured by net property owned, is payable regardless of profit, and is, accordingly, levied on all corporations including those that experience losses during the taxable year.* Moreover, the tendency in State taxation in recent years has been to rely more and more on corporate income taxes. [*Id.* at 17. Emphasis ours].

Respondent's contention that the 90% net income limitation of the WPT is a safeguard against tax liability for an overall unprofitable operation does not affect our result. This is explained in *Robison, supra,* at 601, n. 89:

> This 90% net income limitation raises problems because it is calculated with respect to a "property" and not with respect to the overall profitability of the oil producing entity. Even small oil companies usually own several oil producing properties. Even if one oil property is producing oil at a profit substantial losses from other property may actually put the producer in a net loss position. The windfall profits tax will still have to be paid, however, on the oil produced from the "profitable" property. The possibility that an oil producer would have to pay the windfall profits tax although in a loss position was even recognized by a proponent of the tax. *See* Cong.Rec. S17481-82 (Daily Ed. Nov. 27, 1979) (remarks of Senator Chaffee in response to queries from Senator Armstrong).

We conclude that the WPT is not a tax on or measured by profits or income within the meaning of *N.J.S.A.* 54:10A-4(k)(2)(C).

Reversed.

APPENDIX C

TAX COURT OF NEW JERSEY

Docket Nos. CB 064B-83,
CB 065B-83, CB 066B-83,
CB 067B-83, CB 068B-83,
CB 069B-83, CB 070B-83,
CB 071B-83, CB 072B-83,
CB 073B-83, CB 074B-83,
CB 075B-83, CB 077B-83,
CB 128B-83

AMERADA HESS CORPORATION, DIAMOND SHAMROCK CORPORATION, SHELL OIL COMPANY, CITIES SERVICE COMPANY, EXXON CORPORATION, ATLANTIC RICHFIELD COMPANY, UNION OIL COMPANY OF CALIFORNIA, MOBIL OIL CORPORATION, PHILLIPS PETROLEUM COMPANY, GULF OIL CORPORATION, CHEVRON U.S.A. INC., CONOCO INC., TEXACO, INC., TENNECO OIL COMPANY,

Plaintiffs,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant.

Decided September 28, 1984

CONLEY, J.T.C.

This is a case of statutory construction. It involves the interpretation of only seven words in the New Jersey Corporation Business Tax Act (1945), *N.J.S.A.* 54:10A-1 *et seq.*, but the decision affects deficiency assessments

totalling more than ten million dollars against some of the major oil companies in the United States.

Since the identical legal issue is presented in each of the separate complaints filed by 14 taxpayers, the matters were consolidated for hearing and disposition. Plaintiff-taxpayers have all filed motions for summary judgment and the Attorney General of New Jersey has filed a cross-motion for summary judgment in each case. The parties have filed thousands of pages of briefs, affidavits, depositic transcripts and exhibits in connection with the motions. Some of the record has been sealed by consent pursuant to *R.* 4:10-3 because of the confidential nature of the oil and gas industry.

Stated succinctly, the dispute is whether in computing their entire net income on which the New Jersey corporation business tax is in part assessed, these taxpayers may exclude or deduct the amount of any taxes paid or accrued to the federal government under the Crude Oil Windfall Profit Tax Act of 1980, 94 *Stat.* 229, 26 *U.S.C.A.* §§ 4986-4997. Plaintiffs argue that they may exclude their windfall profit tax liabilities from this computation and the Director of the Division of Taxation argues that they may not do so. Some of the federal tax obligations are substantial, of course, and it follows that it makes a substantial difference whether plaintiffs' net income tax bases for corporation business tax purposes include or exclude the amounts of these federal tax obligations.

The seven statutory words to be construed are contained in the definition of "entire net income" found in *N.J.S.A.* 54:10A-4(K). Insofar as that section is pertinent to this matter it provides as follows:

> (K) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax; provided, however, that in the determination of such entire net income,
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>
> (2) Entire net income shall be determined without the exclusion, deduction or credit of:
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> * * * *
>
> (C) Taxes paid or accrued to the United States *on or measured by profits or income*. . . . [*N.J.S.A.* 54:10A-4(K)(2)(C); emphasis supplied]

The precise issue in this litigation, therefore, is whether the crude oil windfall profit tax is a tax "on or measured by profits or income" within the intent of the corporation business tax act. The intent of the act is paramount because, as the New Jersey Supreme Court observed very recently: "We continue to adhere to the view that our task is to ascertain the legislative intent." *Fedders Financial Corp. v. Division of Taxation Director*, 96 *N.J.* 376, 385-86, 476 *A.*2d 741 (1984.

Although this is the threshhold [*sic*] issue, it has not been adequately addressed by plaintiffs. The court has been presented with a comprehensive and meticulous analysis of the crude oil windfall profit tax and the nuances of federal income and excise tax theory. However, little attention has been paid by the parties to what the apparent legislative purpose was in New Jersey in 1980 when the windfall profit tax was enacted by Congress.

The net income provision was added to the corporation business tax in 1958. *F.W. Woolworth Co. v. Taxation*

Division Director, 45 *N.J.* 466, 473, 213 *A.*2d 1 (1965). The crucial words in the present case were added to the corporation business tax at that time. *L.* 1958, *c.* 63, § 1. Much of the argument of the parties centers around the intent of the Legislature in 1958, but that argument is not very helpful. Since the Crude Oil Windfall Profit Tax Act of 1980 had obviously not been enacted as of then, the Legislature certainly did not intend in 1958 to deal specifically with this federal tax. This does not mean, however, that the Legislature was oblivious to the significance of the windfall profit tax when it was enacted in 1980.

The parties have briefed the court exhaustively on the executive and congressional response in the 1970's to the actions of the Organization of Petroleum Exporting Countries (OPEC) in exercising their power to control the prices of crude oil in the international marketplaces. According to commentators, the windfall profit tax represented the climax of an intense, seven-year debate on national oil policy which raised an issue as to the appropriate distribution of the increased revenues expected to be derived by domestic oil producers as a result of OPEC's actions. Drapkin and Verleger, "The Windfall Profit Tax: Origins, Development, Implications," 4 *B.C.L. Rev.* 631, 633 (1981).

There is no need to dwell on the history or the intricacies of the windfall profit tax. It will suffice to say that the American public was acutely aware of and immediately affected by the oil crisis of the early 1970's. The court takes judicial notice not only that petroleum products were in such short supply that government rationing was necessary, but also that retail prices of petroleum products reached levels previously unimagined in this country. In the face of these compelling circumstances, President Carter proposed the enactment of a windfall profit tax in conjunction with the gradual lifting of federal price controls on crude oil and refined

petroleum products. In his televised address to the nation in which he made this proposal on April 5, 1979, President Carter said:

> I want to emphasize that this windfall profits tax is not a tax on the American people. It is purely and simply a tax on the new profits of the oil producers which they will receive but not earn. [15 *Weekly Comp.* Pres. Docs. 611 (April 5, 1979)]

Conscientious state legislators could have been mindful at that time of the possibility that enactment of the windfall profit tax act might have some impact on state revenues. Had they been concerned, they would have reviewed the language of the corporation business tax pertaining to the net income of corporations. In doing so, they would have been reminded that since 1958 corporations had been assessed a corporation business tax in part on the basis of "total net income from all sources, whether within or without the United States, . . . determined without the . . . deduction . . . of . . . [t]axes paid or accrued to the United States *on or measured by profits or income* . . . ." *N.J.S.A.* 54:10A-4(k)(2)(C); emphasis supplied.

I am entirely satisfied, from the ordinary meaning of these words and from the public perception of the purpose of the windfall profit tax, that the legislators would have been reassured that no amendment of the statutory language was needed to protect the State's revenue source. The Legislature could hardly have been more precise in 1979 than it had been in 1958 to make clear that plaintiffs could not deduct the windfall profit tax when making their determination of entire net income pursuant to *N.J.S.A.* 54:10A-4(K)(2)(C).

Plaintiffs offer a prodigious amount of scholarly analysis to argue that the windfall profit tax is not, in fact, a tax on profits or income and that the name of the tax is a misnomer. Be that as it may, the point is that the Legislature surely perceived the windfall profit tax to

be a tax on profits or income and felt no need to amend the corporation business tax for that very reason. One cannot expect the Legislature to have a command of "the complex and often tortuous federal statutory scheme" of taxation. *See Fedders Financial Corp. v. Taxation Division Director, supra,* 96 *N.J.* at 405, 476 *A.*2d 741 (Handler, J., dissent).

For this very straightforward reason, I hold that the Legislature in 1979 intended to include the Crude Oil Windfall Profit Tax Act of 1980 within the term "[t]axes paid or accrued to the United States on or measured by profits or income" as stated in *N.J.S.A.* 54:10A-4(K)(2)(C). Accordingly, plaintiffs were not entitled to deduct their windfall profit tax obligations in determining their entire net income for 1980.

Plaintiffs contend that this conclusion creates various constitutional problems, primarily under the Commerce Clause, the Equal Protection and Due Process Clauses, and the Supremacy Clause of the United States Constitution. However, as the Attorney General observes, the premise of plaintiff's constitutional arguments is wrong. Plaintiffs allege that this decision means that the net income tax base varies among corporate taxpayers, but the question here is only whether plaintiffs may claim a deduction from their net income tax base, not whether there should be an addition to that portion of the tax base. This decision has no effect on the character of the income included in the tax base.

As a corollary of this, it is also incorrect for plaintiffs to argue that federal law determines the amount of a taxpayer's entire net income under the Corporation Business Tax Act. I subscribe fully to the construction of the act by Judge Andrew of this court, who has said:

> There is no support for the proposition that federal income tax concepts are the definitional source of the terms utilized in the New Jersey Act.
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> * * * *
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> While the starting point for determination of entire net income under the act is taxable income, before net operating loss deductions and special deductions, which the taxpayer is required to report for federal income tax purposes, the Corporation Business Tax deviates from the federal tax by providing its own inclusions and exclusions from the tax base. *N.J.S.A.* 54:10A-4(K). Only at the initial point is it indicated that the Legislature intended that federal standards were to be controlling. [*International Flavors and Fragances v. Taxation Division Director,* 5 *N.J. Tax* 617, 624 (Tax Ct. 1983), aff'd *o.b.* (App. Div. 1984)]

The deficiency assessments of the Director are therefore affirmed. The Clerk of the Tax Court shall enter appropriate judgments.

APPENDIX D

TAX COURT OF NEW JERSEY

Docket Nos. CB 064B-83,
CB 065B-83, CB 066B-83,
CB 067B-83, CB 068B-83,
CB 069B-83, CB 070B-83,
CB 071B-83, CB 072B-83,
CB 073B-83, CB 074B-83,
CB 075B-83, CB 077B-83,
CB 128B-83

AMERADA HESS CORPORATION, DIAMOND SHAMROCK CORPORATION, SHELL OIL COMPANY, CITIES SERVICE COMPANY, EXXON CORPORATION, ATLANTIC RICHFIELD COMPANY, UNION OIL COMPANY OF CALIFORNIA, MOBIL OIL CORPORATION, PHILLIPS PETROLEUM COMPANY, GULF OIL CORPORATION, CHEVRON U.S.A. INC., CONOCO INC., TEXACO, INC., TENNECO OIL COMPANY,

Plaintiffs,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant.

February 14, 1985

LARIO, J.T.C.

This is a consolidated motion filed by all plaintiffs for reconsideration of summary judgments entered by this court dismissing all plaintiffs' complaints. Plaintiffs, 14 taxpayers, originally filed complaints attacking deter-

minations of defendant, Director, Division of Taxation (Director) whereby he denied their respective claims for deductions under the New Jersey Corporation Business Tax Act (CBT), *N.J.S.A.* 54:10A-1, *et seq.*

These complaints were assigned to Judge Richard M. Conley for hearing and determination. By reason of identity of legal issues, they were consolidated for hearing and since the material facts were not in dispute, motions for summary judgment were filed by all parties. In support of their respective motions, comprehensive pleadings, including thousands of pages of briefs, transcripts of depositions and affidavits were submitted by all parties and oral arguments were presented.

On September 28, 1984, Judge Conley issued his decision granting defendant's motion for summary judgment in each case affirming the deficiency assessments imposed against each of the plaintiffs. *Amerada Hess Corp. v. Taxation Div. Director*, 7 *N.J.Tax* 51 (Tax Ct 1984). Judgments to that effect as to all assessments levied for the taxable year 1980 were entered on October 5, 1984. Subsequently, corrected judgments were entered on October 16, 1984 as to five of the plaintiffs whose assessments for the taxable year 1981 were also contested.

Thereafter, within the time period permitted by our rules, all plaintiffs joined in motions for reconsideration. Shortly after rendering his decision, Judge Conley resigned as a judge of this court to resume the private practice of law and these motions were assigned to me to hear and determine.

In its brief opposing plaintiffs' motions the Director agrees with a request contained in plaintiffs' brief that the contested assessments in docket nos. CB 075B-83 (Conoco, Inc.) and CB 069B-83 (Atlantic Richfield Company) (tax year 1980 only) were reductions of refund claims, not deficiency assessments, and he joins in plain-

tiffs' request that these judgments be corrected accordingly. This motion is granted and the Clerk of the Tax Court is directed to issue corrected judgments.

Plaintiffs filed their motions pursuant to *R.* 4:49-1, *R.* 4:49-2, *R.* 4:50-1(f), *R.* 8:7(a) and *R.* 8:10, for the following relief: (1) reconsideration of the opinion of the Tax Court dated September 28, 1984, denying the motions of plaintiffs for summary judgment, granting the motion of defendant for summary judgments and dismissing the complaints of plaintiffs; (2) vacation of the judgment and corrected judgments dated October 5, 1984 and October 16, 1984 respectively, entered pursuant thereto, affirming the 1980, and, as applicable, 1981 assessments, and dismissing the complaints of plaintiffs; and, (3) entry of summary judgments in favor of plaintiffs for the relief requested in their respective complaints.

In his answering brief, defendant denies that *R.* 4:50-1(f), *R.* 8:7(a) and *R.* 8:10 are applicable for this type of motion. At oral argument plaintiffs agreed with Director's contentions and stated that they were relying upon *R.* 4:49-1 and -2 for the relief requested and that the other rules cited were not applicable.

R. 4:49-2 deals with a motion to "alter or amend" a judgment and it apparently covers cases such as here where no trial was held and since it sets forth no separate substantive standards, it is presumed that its standards are identical to those applicable to *R.* 4:49-1.

R. 4:49-1 specifies that in an action tried without a jury, on motion, the trial judge may open the judgment, take additional testimony, amend findings of fact and conclusions of law and direct the entry of judgment. It further provides: "The trial judge shall grant the motion if, having given due regard to the opportunity of the jury to pass upon the credibility of the witnesses, it

clearly and convincingly appears that there was a miscarriage of justice under the law." *Ibid.*

Although the "miscarriage of justice" standard refers to jury trials, it is clear that the standard also applies to motions in nonjury cases. *Quick Chek Food Stores v. Springfield Tp.* 83 *N.J.* 438, 445, 416 A.2d 840 (1980). Under this rule motions "are addressed to the sound discretion of the trial court and [that judgment] will not be disturbed unless that discretion has been clearly abused." *Id.* at 445-446, 416 *A.*2d 840.

The Supreme Court in *Quick Chek* also made it clear that the parallel federal rule (*Fed.R.Civ.P.* 59) may be considered as a guide for interpreting *R.* 4:49-1. *Id.* at 446, 416 *A.*2d 840. The Federal rule mandates that a motion for a new trial should be premised only upon a "manifest error of law", "manifest error of fact", or "newly discovered evidence." II *C. Wright and A. Miller, Federal Practice and Procedure* (1980) § 2804; *Pioneer Paper Stock Co. v. Miller Transport Co.*, 109 *F.Supp.* 502, 504 (D.N.J.1983).

From an examination of the reasons advanced in support of their motions it appears that plaintiff's main objections are their dissatisfaction with the judge's written opinion. Most of their arguments, raised in their supporting briefs and presented orally, are directed against the opinion's content, brevity and failure to discuss certain issues and not against the judge's conclusion and final judgment. They complain of the court's alleged failure to comment upon most of the evidence submitted and to address many of the arguments presented.

Plaintiffs advise that regardless of which party prevails in this court, an appeal will be taken to the Appellate Division and probably will be further pursued to the Supreme Court. One of the objections, in support of this motion, raised by one plaintiff is that although their

positions were fully presented and exhaustively briefed, each was not specifically discussed and commented upon in the opinion; and, that on appeal, this failure is not fair to the plaintiffs nor to the Appellate Division. The basis for this position was that even though the appellate court would have the benefit of the record and appellate briefs, to require the appellate judges to examine these voluminous pleadings and to consider "all the merits from scratch" would be an imposition upon an Appellate Division which is "overworked" and entitled to the full benefits of the Tax Court's expertise which would have appeared in a much more comprehensive and detailed opinion.

This position as a basis for a reconsideration is completely unsupported by any legal authority. It is clear that appeals may not be taken from opinions; they may be taken only from judgments. *R.* 2:2-3(a)(1). As declared by our Supreme Court, "He [the appellant] voices dissatisfaction with the opinion of the Appellate Division. Appeals, however, are taken from judgments and not from opinions." *Hughes v. Eisner*, 8 *N.J.* 228, 229, 84 *A.*2d 626 (1951). "It has long and invariably been recognized, in particular, that no appeal lies from opinions or from written oral conclusions of courts, but only from judgment or orders." *Credit Bureau Collection Agency v. Lind*, 71 *N.J. Super.* 326, 328, 177 *A.*2d 36 (App. Div. 1961); *Melhame v. Demarest Boro.*, 174 *N.J. Super.* 28, 31, 415 *A.*2d 358 (App. Div. 1980); *cf. Seabrook Co. v. Beck*, 174 *N.J. Super.* 577, 584, 417 *A.*2d 89 (App. Div. 1980). "Appeals are taken from judgments not opinions and . . . a respondent can argue any point on the appeal to sustain the trial court's judgment. *State v. Siciliano*, 21 *N.J.* 249, 260 [121 *A.*2d 490] (1956)." *Chimes v. Oritano Motor Hotel, Inc.* 195 *N.J. Super.* 435, 443, 480 *A.*2d 218 (App. Div. 1984).

In deciding a motion for summary judgment, where as here, the material facts are not in dispute, the trial

judge should concisely and lucidly identify the legal issues involved and give a clear pronouncement of the ultimate conclusion and reasons therefor. This, Judge Conley has done. It was neither required nor necessary for the court to have discussed at length and responded to all of the many issues and principles of law raised in the parties' extensive briefs where, as here, only one narrow legal issue (albeit important) was determined by the court to exist. Once having determined the issue to be decided, only such essential facts, reasoning and conclusions as applied by him to that particular issue were required to be documented. I hold that plaintiffs' objections to the format, brevity and alleged omissions of the opinion have no merit on a motion for a new trial and do not warrant further consideration.

Since the motions do not allege a "manifest error of fact" and they are not based upon an evidence question, as are usually the basis for motions under this rule, in order for a reconsideration motion to be granted under *R.* 4:49-1, it must be established clearly and convincingly that the trial judge's conclusion was based upon a "manifest error of law" which will result in a "miscarriage of justice."

Since the "miscarriage of justice" standard applies to nonjury actions it is also applicable to completed nonjury actions reassigned to another trial judge such as occurred here. However, it is manifest that in considering this motion, I am not sitting as an appellate court. I am on the same judicial level as the origial trial judge; therefore, I may not substitute my interpretation of the Legislature's intent for his. The test is not whether I would have arrived at a different conclusion had I heard the matter initially.

Plaintiffs concede the dispute between the parties is, as stated by Judge Conley: ". . . whether in computing their entire net income on which the New Jersey Corpo-

ration Business Tax is in part assessed, these taxpayers may exclude or deduct the amount of any taxes paid or accrued to the federal government under the Crude Oil Windfall Profit Tax Act of 1980, 94 *Stat.* 229, 26 *U.S.C.A.* §§ 4986-4997." *Amerada Hess Corp. v. Taxation Div. Director, supra,* 7 *N.J. Tax* at 53. They further concede that he correctly concluded that the resolution thereof is controlled by the statutory construction of the seven words of subsection (C): "taxes paid or accrued to the United States *on or measured by profits or income* . . ." as contained in the definition of "entire net income" found in *N.J.S.A.* 54:10A-4(k)(2)(C)." *Id.* at 56; emphasis in original.

The net income provision of this statute was added to the CBT in 1958. Since the Crude Oil Windfall Profit Tax Act (WPT) had not been enacted by Congress until 1980, in determining the Legislature's intent in adopting the statutory words in dispute, Judge Conley relied upon the principle of probable legislative intent (of the 1958 Legislature) had it anticipated the facts herein.

After analyzing the facts and circumstances of the situation, Judge Conley was satisfied and concluded "from the ordinary meaning" of the words contained in *N.J.S.A.* 54:10A-4(k)(2)(C) and "from the public perception of the purpose of the WPT" that the Legislature in 1979 by not amending this section of the CBT "intended to include the Crude Oil Windfall Profit Tax Act of 1980 within the term "[t]axes paid or accrued to the United States on or measured by profits or income" as stated in *N.J.S.A.* 54:10A-4(k)(2)(C)." *Id.* at 56-57.

In their motions for reconsideration plaintiffs allege that the court's final judgment is erroneous as a matter of law since

> in holding that the WPT is a tax "on or measured by profits or income" within the meaning of *N.J.S.A.* 54:10A-4(k)(2)(C), the Tax Court (i) ignored the ordinary and generally accepted meanings of the terms "income" and "profits" and their accepted senses under general tax law, as delineated by commentators and courts, both Federal and State [footnote omitted], (ii) made no mention whatsover of the use of the terms "income" and "profits" in the definition of "entire net income" in *N.J.S.A.* 54:10A (k) and the relationship between those terms so used, and their uses in *N.J.S.A.* 54:10A4(k)(2)(C), (iii) summarily dismissed as irrelevant the only available legislative history concerning the "entire net income" base of the CBT, namely, that relating to the objective of our Legislature in adding that base to the CBT in 1958, and (iv) disavowed any felt need to even consider the nature and structure of the WPT, much less "the intricacies" of that tax.

In arriving at his conclusion on the first error alleged by (i) above, the judge reasoned that it was not determinative whether the WPT *was in fact* a tax on or measured by profits or income; but instead what the Legislature perceived it to be. Plaintiffs have failed to submit any legal authority (and this court's extensive research has also failed to disclose any) to establish that Judge Conley's analysis of the Legislature's intention on this issue is clearly erroneous as a matter of law.

Plaintiffs further claim that the trial judge's reliance on the principle of "probable legislative intent" and utilizing "legislative silence" in his analysis and interpretation of the CBT constitutes error as a matter of law. They state that the court's determination of what was the 1979 and 1980 Legislature's probable intent on this issue is unsupported by legal authority.

Statutory words cover many diverse instances which cannot be foreseen, therefore, their interpretation is necessarily an imaginative projection of the express purposes upon situations arising later for which the Legisla-

ture did not expressly provide. As expressed by Professor Walker Gibson, a member of the faculty of New York University Law School at a seminar for appellate judges:

> In the case of the legislature's intention the difficulty is that time has gone barreling on long after the legislature has spoken, and new situations have arisen about which the legislature clearly never had any intention at all. The question then becomes rephrased into something like, "What *would* the legislature have intended *if* the legislature had known what was going to happen?" Gibson, "Literary Minds and Judicial Style," 36 *N.Y.U.L. Rev.* 915, 920 (1961).

When the judiciary is called upon to interpret the meaning of a statute in such a situation, it does not substitute its will for the legislative will but rather in the consideration of all the material elements reaches the result probably intended by the Legislature. *Dorkin v. Dover Tp.*, 29 *N.J.* 303, 315, 148 *A.*2d 793 (1959). The statutory construction required thereby is referred to as "probable legislative intent." The application of this doctrine was recently set forth by our Supreme Court in *AMN, Inc. v. So. Bruns. Tp. Rent Leveling Bd.*, 93 *N.J.* 518, 461 *A.*2d 1138 (1983) as follows:

> Generally, a court's duty in construing a statute is to determine the intent of the Legislature. In cases such as this, where it is clear that the drafters of a statute did not consider or even contemplate a specific situation, this Court has adopted as an established rule of statutory construction the policy of interpreting the statute "consonant with the probable intent of the draftsman 'had he anticipated the situation at hand.'" [citations omitted] Such an interpretation will not "turn on literalisms, technisms or the so-called rules of interpretation; [rather] it will justly turn on the breadth of the objectives of the legislation and the commonsense of the situation." *J.C. Chap. Prop Owner's Protective Ass'n v. City Council of Jersey City*, 55 *N.J.* [86] at 100 [259 *A.*2d 698 (1969)] [At 525, 461 *A.*2d 1138].

Judge Conley, after analyzing what he perceived to be the "commonsense of the situation" interpreted the Legislature's failure to amend our CBT after the federal enactment of WPT as an indication by our Legislature that "it perceived the windfall profit tax to be a tax on profits or income and felt no need to amend the Corporation Business Tax for that very reason." *Amerada Hess Corp., supra*, 7 *N.J. Tax* at 56.

In further criticizing the trial judge's interpretation of the Legislature's probable intent, plaintiffs allege that the "significance attributed by the court to Legislative inactivity" is "flatly inconsistent with binding precedent." I do not find that the decisions cited so hold. In each of the cases presented by plaintiffs, no definite judicial interpretation or legislative act intervened between the adoption of the statute being interpreted and the claimed legislative silence. In such situations, as plaintiffs have correctly stated, our courts have held there is nothing in which the Legislature could acquiesce; but, in the case under review, the trial court found as a fact that there was something definite to which the New Jersey Legislature could have reacted—the federal enactment of the WPT. This distinction is pointed out in *White v. N. Bergen Tp.*, 77 *N.J.* 538, 555, 391 *A.*2d 911 (1978). In arriving at his finding concerning the Legislatures' inaction, Judge Conley explicitly considered the wide publicity given to the adoption of the WPT.

In *White, supra*, Chief Justice Hughes also made it clear that although legislative silence is not conclusive, it may be significant. *Id.* at 555, 391 *A.*2d 911. In reaching his final conclusion of the intent of the 1955

Legislature, Judge Conley did not accept the 1979-1980 Legislature's silence as conclusive but instead took it into consideration in interpreting that intent.

Plaintiffs disagree with the significance and reliance that the trial court placed upon the Legislature's inactivity on this subject and the court's reasoning and conclusions as to the 1955 Legislature's probable intent; they claim it to be erroneous. However, whether it is erroneous and subject to reversal by an appellate court is not the test before me. As previously posited: Is it, as required by *R.* 4:49-1 and interpreted by *Quick Chek, supra,* clearly and convincingly a manifest error as a matter of law? Plaintiffs have cited many cases which they claim support their position but I find from an analysis of each that none supports their claim that Judge Conley's judicial interpretation of the Legislature's silence and probable intent is incorrect as a matter of law.

It is recognized that trial court judges are not infallible and on appeal their orders and judgments may be reversed and, at times, the reversal is reversed. Strictly, every reversal by an upper court is a determination that the lower court's conclusion constituted an error as a matter of law; however, every erroneous conclusion is not necessarily clear or a "manifest" error. Manifest is defined as "1. readly perceived by the sight; 2. easily understood or recognized by the mind: obvious." *Webster's New Collegiate Dictionary* (9 ed. 1983) at 724.

The precise legal issue presented to the trial court had never before been passed upon by a court of record in this State; therefore, there exists no guiding prior determination. Judge Conley was required to examine the statute, dissect and analyze its meaning and conclude the intent of the seven words in issue. Based upon his analysis of the statute, Judge Conley concluded that plaintiffs were not entitled to deduct their WPT obligations in

determining their entire net income. Plaintiffs disagree with his conclusion.

Since there has been no prior court decision on this issue, it cannot be said that his conclusion is clearly a manifest error as a matter of law. Whether, on appeal, our appellate courts will ultimately affirm Judge Conley's judgment is a matter for future determination. It has often been said in judicial circles that "an occupational hazard of a judge is that he may be wrong" but that wrong does not necessarily constitute "manifest error." As aptly stated by Judge Charles M. Merrill of the Ninth Circuit, United States Court of Appeals:

> To an appellate judge, dealing with principles of law rather than with physical facts, what is "right" and what is "wrong" is largely a question of opinion. There is very little that is absolute. When one is declared "wrong" by a majority of one's brothers or by a higher court it can often be said simply that there is a difference of opinion. Personally I do not see why any greater opprobruim should attend reversal by a higher court than attends the filing of a dissenting opinion. In either case all that is revealed is that opinions differ and that upon this difference one is in the minority. And whenever there is difference someone must be in the minority; and if there were no room for difference there would be little need for appellate courts. [Merrill, "Some Reflections on the Business of Judging," 40 *Cal. St. B.J.* 811, 814 (1965)]

I conclude that plaintiffs have failed to establish the existence of either a manifest error of law or a miscarriage of justice as required by *R.* 4:49-1 or -2. Motions for reconsideration are denied.

APPENDIX E

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,264

Civil Action

AMERADA HESS CORPORATION,
Appellant,

—vs—

JOHN R. BALDWIN, ACTING DIRECTOR,
DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Amerada Hess Corporation, the Appellant above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. Sec. 1257(2).

WILENTZ, GOLDMAN & SPITZER
A Professional Corporation

By: /s/ Frederic K. Becker
FREDERIC K. BECKER
Counsel for Appellant

WILENTZ, GOLDMAN & SPITZER
A Professional Corporation
900 Route 9, P.O. Box 10
Woodbridge, New Jersey 07095
201-636-8000
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25.277

Civil Action

ATLANTIC RICHFIELD COMPANY,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Atlantic Richfield Company, the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,272

Civil Action

CHEVRON U.S.A. INC.,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Chevron U.S.A. Inc., the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,275

Civil Action

CITIES SERVICE COMPANY,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Cities Service Company, the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,276

Civil Action

CONOCO INC.,

Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,

Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Conoco Inc., the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,274

Civil Action

EXXON CORPORATION,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Exxon Corporation, the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,269

Civil Action

GULF OIL CORP.,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Gulf Oil Corp., the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,271

Civil Action

MOBIL OIL CORP.,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Mobil Corp., the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,273

Civil Action

PHILLIPS PETROLEUM COMPANY,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Phillips Petroleum Company, the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
33 Washington Street
Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE OF NEW JERSEY

Docket No. 25,268

Civil Action

SHELL OIL COMPANY,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Shell Oil Company, the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
Counsel for Appellant

STRYKER, TAMS & DILL
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Newark, New Jersey 07102
(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

IN THE SUPREME COURT OF
THE STATE CF NEW JERSEY

Docket No. 25,270

Civil Action

UNION OIL COMPANY OF CALIFORNIA,
Appellant,

—vs—

DIRECTOR, DIVISION OF TAXATION,
Appellee.

[Received Aug. 20, 1987]

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that Union Oil Company of California, the Appellant above-named, HEREBY APPEALS to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of New Jersey entered in this action on June 22, 1987, reversing the judgment of the New Jersey Superior Court, Appellate Division, and reinstating the judgment of the New Jersey Tax Court (i) denying the motion of Appellant for summary judgment, (ii) granting the cross-motion of Appellee for summary judgment and, pursuant thereto, (iii) dismissing the complaint of Appellant.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

STRYKER, TAMS & DILL

By: /s/ Charles M. Costenbader
CHARLES M. COSTENBADER
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(201) 624-9300
Counsel for Appellant

Dated: August 20, 1987

[Certificate of Service omitted]

APPENDIX F

TABLE OF AMOUNTS AT ISSUE FOR 1980 AND 1981

	1980				1981			
Company	N.J. CBT Liability Excluding WPT Payments	N.J. CBT Liability After Add-Back of WPT Payments	Additional Tax Liability Attributable to WPT Add-Back	Percentage Increase in Tax Burden	N.J. CBT Liability Excluding WPT Payments	N.J. CBT Liability After Add-Back of WPT Payments	Additional Tax Liability Attributable to WPT Add-Back	Percentage Increase in Tax Burden
Amerada Hess	$10,852,307	$12,504,242	$1,651,935	15%	$ 864,208	$ 7,561,840	$ 6,697,632	775%
Atlantic Richfield	$ 1,275,921	$ 1,633,808	$ 357,887	28%	$ 477,001	$ 1,309,033	$ 832,032	174%
Chevron	$ 5,825,582	$ 6,947,422	$1,121,840	19%				
Cities Service	$ 1,344,049	$ 1,618,395	$ 274,346	20%	—0—	$ 912,204	$ 912,204	∞
Conoco	$ 385,665	$ 523,399	$ 137,734	36%				
Exxon	$15,314,745	$19,038,950	$3,724,205	24%				
Gulf	$ 638,411	$ 997,987	$ 59,576	56%	$ 112,834	$ 1,356,153	$ 1,243,319	1102%
Mobil	$ 1,711,268	$ 2,235,947	$ 524,679	31%				
Phillips	$ 170,593	$ 195,684	$ 25,091	15%				
Shell	$ 2,749,654	$ 3,509,330	$ 759,676	28%	$3,039,560	$ 5,031,746	$ 1,992,186	66%
Union	$ 315,124	$ 384,965	$ 69,841	22%				
Total	$40,583,319	$49,590,129	$9,006,810	22%	$4,493,603	$16,170,976	$11,677,373	260%

Source: The figures in this table were derived from the complaints, assessment notices, and final determination letters contained in the record.

APPENDIX G

SUMMARY OF STATE TAX SCHEMES DENYING DEDUCTION FOR WINDFALL PROFIT TAX PAYMENTS

1. *Georgia.* The state code provides that "[e]very domestic corporation and every foreign corporation shall pay annually an income tax" on "its Georgia taxable net income." Ga. Code Ann. § 48-7-21(a) (Supp. 1987). Where a corporation conducts business both within and without the state, Georgia taxes that "portion of [its] net income . . . attributable to property owned or business done within [the] state" as determined in accordance with a three-factor (property, payroll, and gross receipts) formula. § 48-7-31(d)(2).

Georgia bases its definition of "taxable net income" on the federal scheme. Under the state code, a "corporation's taxable income from property owned or from business done in [the] state shall consist of the corporation's taxable income as defined in the Internal Revenue Code of 1986, with [specified] adjustments." § 48-7-21(a). One such adjustment requires an add-back of various taxes, including "any taxes on, or measured by, net income or net profits paid or accrued within the taxable year imposed by the authority of the United States . . . to the extent such taxes are deducted in determining federal taxable income." § 48-7-21(b)(2).

Georgia tax administrators have taken the audit position that the WPT is a tax "on, or measured by, net income or net profits" deductible for federal tax purposes and that WPT payments must therefore be added back to the federal tax base to determine "taxable net income" under the state code.

2. *Iowa.* The state taxes the "net income" of "each [domestic] corporation" and "every foreign corporation

doing business in [the] state." Iowa Code § 422.33 (1971 & Supp. 1987). The state code uses a single-factor (gross sales) formula to apportion to Iowa a share of the net income of a corporation doing business both within and without the state. § 422.33.2(b)(4). Under the state code, the "term 'net income' means the taxable income before the net operating loss deduction, as properly computed for federal income tax purposes under the Internal Revenue Code," with specified "adjustments." § 422.35.

In 1982, the state amended the code, retroactive to tax years beginning on or after January 1, 1981, and expanded its list of "adjustments." Pursuant to that amendment's plain language as requiring an add-back under section 164(a) of the Internal Revenue Code" must be added to federal taxable income for purposes of computing net income subject to the Iowa corporate tax. § 422.35.10.

In *Shell Oil Co. v. Bair*, No. CL 47-27321 (Iowa Dist. Ct. Nov. 19, 1986), a state district court construed the amendment's plan language as requiring an add-back only when the taxpayer had deducted WPT payments under I.R.C. § 164(a) in determining federal taxable income. By contrast, if the taxpayer included its WPT payments as part of its "cost of goods sold" under I.R.C. § 471, the WPT payments need not be added back. While upholding Shell's position on statutory grounds, the court in a companion case rejected its constitutional attack on the add-back of WPT payments. *Shell Oil Co. v. Blair*, No. CL 062-36611 (Iowa Dist. Ct. Nov. 19, 1986).

The state has appealed the statutory construction ruling, and Shell has appealed the constitutional determination, to the Iowa Supreme Court. *Shell Oil Co. v. Bair*, Nos. 86-1731 (constitutional issue) and 86-1747 (statutory issue) (Iowa Sup. Ct., argued Sept. 17, 1987).

3. *Minnesota.* The state imposes a "privilege and income" tax on the "taxable net income" of foreign and domestic corporations doing business in the state. Minn. Stat. § 290.06(1) (1962 & Supp. 1987). The definition of "taxable net income" is not keyed to the federal scheme. "The term 'net income' means the [corporation's] gross income" minus "the deductions allowed by section 290.09" of the state code. § 290.01(19)(a). The "taxable net income from a trade or business carried on partly within and partly without [the] state shall be computed by deducting from the gross income of such business, wherever derived, deductions of the kind permitted by section 290.09." § 290.19(1). "The remaining net income shall be apportioned to Minnesota" based on a three-factor (property, payroll, and gross receipts) formula. § 290.19(1).

In computing taxable net income, a deduction from gross income is permitted for "[t]axes paid or accrued within the taxable year, *except* . . . (c) federal income taxes (including the windfall profit tax on domestic crude oil)." § 290.09(4) (emphasis added). The state added the parenthetical language prohibiting the deduction of WPT payments in 1981. 1981 Minn. Laws Ch. 60, § 8. The amendment was made effective retroactively as of March 1, 1980 (the effective date of the WPT) for all taxable years ending after that date.

4. *New York.* The state franchise tax is computed "upon the basis of [a corporation's] entire net income." N.Y. Tax Law § 209.1 (McKinney 1986). For corporations doing business both within and without New York, the state's income share is determined by multiplying the corporation's "entire net income" by a three-factor (property, payroll, and gross receipts) formula. § 210.3(a).

"The term 'entire net income' means total net income from all sources, which shall be presumably the same as

the entire taxable income which the taxpayer is required to report to the United States treasury department . . . ." § 208.9. For state franchise tax purposes, however, "[e]ntire net income shall be determined without the exclusion, deduction or credit of . . . taxes on or measured by profits or income paid or accrued to the United States." § 208.9(b)(3). The New York State Tax Commission, in an "Opinion of Counsel," has ruled that the WPT is a tax on or measured by profits and that, as a consequence, WPT payments cannot be deducted in computing the state tax base. TSB-M-82(22)C, Corporation Tax (July 12, 1982), *reprinted in* 1 N.Y. St. & Loc. Tax. Serv. (P.H.) ¶ 13,229; 1 N.Y. St. Tax Rep. (CCH) ¶ 9-909.

5. *North Dakota.* The state imposes a tax on the "taxable income" of corporations doing business there, as apportioned to North Dakota by a four-factor (property, payroll, gross sales, cost of goods sold) formula. N.D. Cent. Code § 57-38 (1981 & Supp. 1987). " 'Taxable income' . . . shall mean the taxable income . . . for federal income tax purposes under the United States Internal Revenue Code of 1954, as amended, plus or minus such adjustments as may be provided by this act and chapter or other provisions of law." § 57-38-01.8. In computing North Dakota taxable income, a corporation's federal taxable income must be "[i]ncreased by the amount of any income taxes . . . to the extent that such taxes were deducted to determine federal taxable income." § 57-38-01.3.1(d).

For the initial year of the WPT's effectiveness, the state enacted a special statute governing the state tax treatment of WPT payments. It provided: "As to individuals, estates, trusts, and corporations, the crude oil windfall profit tax . . . shall be allowable as a deduction in computing taxable income for the first taxable year only, beginning on or after January 1, 1980; provided that the deduction for a corporation shall not

exceed one million dollars." Former § 57-38-01.21(a) N. Dak. St. Tax Rep. [CCH] ¶ 11-018. For subsequent tax years, the state has apparently allowed taxpayers to treat WPT payments as fully deductible from the state's tax base. Moreover, because North Dakota has not treated the WPT as an "income" tax, WPT payments have not been subject to the state's add-back provision, which applies to "income taxes" or "franchise or privilege taxes measured by income." § 57-38-01.3(d). As a practical matter, therefore, the only limit that North Dakota has placed on the deductibility of WPT payments is the $1 million cap applicable to corporations in 1980.

6. *South Carolina.* With respect to a multistate enterprise conducting business within South Carolina, the state imposes a tax on the portion of its "entire net income" that "reasonably represents the proportion of the trade or business carried on within [the] State." S.C. Code Ann. §§ 12-7-230, 12-7-250 (Law. Co-op. 1977 & Supp. 1986). The state uses a three-factor (property, payroll, and gross receipts) formula to derive an apportioned share of the business's "entire net income." *See* S.C. State Tax Commission Regulation 117-87.17.

Beginning in 1985, South Carolina's corporate tax definitions are based on the federal system. Before that, the state code defined "net income" as "the gross income of a taxpayer less the deductions allowed by this chapter." § 12-7-600 (Law. Co-op. 1977), *repealed by* South Carolina Income Tax Federal Conforming Amendments of 1985, § 22 (May 21, 1985). Former section 12-7-700 specified the allowable deductions from "gross income." It provided in relevant part: "In computing net income there shall be allowed as deductions . . . [t]axes for the income year in the amount allowed for Federal Tax purposes, under § 164 of the Internal Revenue Code in effect as of December 31, 1980, except taxes on income,

taxes with respect to income or taxes measured by income."

Even before the 1985 legislation, the South Carolina courts generally followed federal precedent and viewed federal and state concepts of income as analogous. *See, e.g., Scott v. Tax Commission*, 262 S.C. 144, 202 S.E.2d 854, 855 (1974). Since 1985, "South Carolina gross income and taxable income of a corporation" has been expressly defined as "the corporation's gross income and taxable income as determined under the Internal Revenue Code with [specified] modification." § 12-7-415 (Law. Co-op. Supp. 1986). The state code provides that the "deductions used in computing adjusted gross income and taxable income" for federal tax purposes must be "modified" in several respects. § 12-7-430(d). On such modification specifies that "there is no deduction for . . . any income taxes, or any taxes measured by or with respect to net income." § 12-7-430(d)(1).

In 1982, the South Carolina Attorney General issued an opinion on the deductibility of WPT payments. Relying on South Carolina case law that all "ambiguity" must be resolved against the taxpayer, the Attorney General concluded that the "windfall profit tax is . . . a tax with respect to income" because it "focuses on specific profits" and that WPT payments therefore "may not be deducted in computing net income." 82 Op. Att'y Gen. No. 13 (Mar. 10, 1982). Based on that opinion, the state does not allow a deduction for WPT payments.

6. *Wisconsin.* The state imposes a franchise tax on the "entire net income" of any corporation doing business within its borders. Wis. Stat. § 71.01(12) (1969 & Supp. 1986). If the corporation is a multistate unitary business, Wisconsin taxes an apportioned share of the enterprise's entire net income determined pursuant to a three-factor (property, payroll, and sales) formula. § 71.07 (2).

Under the Wisconsin code, " '[n]et income' means, for corporations, 'gross income' less allowable deductions." § 71.02(1)(c). When the WPT was enacted, the state code provided that, in determining "net income," "[i]ncome, excess profits, war profits and capital stock taxes imposed by the federal government are not deductible from gross income." § 71.04(3) (Supp. 1986). The state legislature, however, apparently did not believe that the WPT, as a "temporary excise tax" on crude oil production, was subject to that provision. Wisconsin Legislative Fiscal Bureau, Analysis of Amendment to Wis. State. § 71-04 (Apr. 23, 1981). The state therefore amended section 71.04(3) to add that "the windfall profit tax under section 4986 of the internal revenue code is not deductible from gross income." 1981 Wis. Laws ch. 20, § 1090c (July 31, 1981).

In *Mobil Oil Corp. v. Ley*, No. 82 CV 4819 (Wis. Cir. Ct. April 3, 1986), the court rejected the taxpayer's constitutional and other challenges to the non-deductibility of WPT payments. The case is currently pending on appeal. *Mobil Oil Corp. v. Ley*, No. 86-1221 (Wis. Ct. App., Dist. IV).

APPENDIX H

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution:

> The Congress shall have power . . . .
>
> To regulate Commerce with Foreign Nations, and among the several States . . . .

Amendment XIV, Section 1 of the United States Constitution:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

New Jersey Corporation Business Tax Act

§ 54:10A-2. Franchise tax; annual payment in lieu of taxes upon intangible personal property; "doing business, employing or owning capital or property in state" defined

Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax for the year 1946 and each year thereafter, as hereinafter provided, for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act but, whenever such corporation holds shares of stock in a bank as defined in R.S. 54:9-1, and such bank has not elected to have the taxable value of such shares assessed to it and to pay the tax levied against such shares as provided in R.S. 54:9-14, or, having made such election, such bank subsequently revokes it, the provisions of this section shall not exempt such shares of stock from the tax imposed by chapter 9 of Title 54 of the Revised Statutes.

A foreign corporation shall not be deemed to be doing business, employing or owning capital or property in the State, for the purposes of this act, by reason of (1) the maintenance of cash balances with banks or trust companies in this State, or (2) the ownership of shares of stock or securities in this State if such shares or securities are pledged as collateral security, or deposited with one or more banks or trust companies or brokers who are members of a recognized security exchange, in safekeeping or custody accounts, or (3) the taking of any action by any such bank or trust company or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation.

§ 54:10A-4. **Definitions**

For the purposes of this act, unless the context requires a different meaning:

. . . .

(k) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax; provided, however, that in the determination of such entire net income,

. . . .

(2) Entire net income shall be determined without the exclusion, deduction or credit of:

. . . .

(C) Taxes paid or accrued to the United States on or measured by profits or income, or the tax imposed by this act, or any tax paid or accrued with respect to subsidiary dividends excluded from entire net income as provided in paragraph (5) of subsection (k) of this section;

§ 54:10A-5. **Amount of franchise tax**

The franchise tax to be annually assessed to and paid by each taxpayer shall be the sum of the amount computed under subsection (a) hereof, or in the alternative to the amount computed under subsection (a) hereof, the amount computed under subsection (f) hereof, and the amount computed under subsection (c) hereof:

(a) That portion of its entire net worth as may be allocable to this State as provided in section 6, multiplied

by the following rates: 2 mills per dollar on the first \$100,000,000.00 of allocated net worth; 4/10 of a mill per dollar on the second \$100,000,000.00; 3/10 of a mill per dollar on the third \$100,000,000.00; and 2/10 of a mill per dollar on all amounts of allocated net worth in excess of \$300,000,000.00; provided, however, that with respect to reports covering accounting or privilege periods set forth below, the rate shall be that percentage of the rate set forth in this subsection for the appropriate year:

Accounting or Privilege Periods Beginning on or After:	The Percentage of the Rate to be Imposed Shall Be:
April 1, 1983	75%
July 1, 1984	50%
July 1, 1985	25%
July 1, 1986	0

(b) (Deleted by amendment, P.L.1968, c. 250, s. 2.)

(c) 3¼% of its entire net income or such portion thereof as may be allocable to this State as provided in section 6; provided, however, that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1967, the rate shall be 4¼%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1971, the rate shall be 5½%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1974, the rate shall be 7½%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1979, the rate shall be 9%.

(d) Provided, however, that the franchise tax to be annually assessed to and paid by any investment company or real estate investment trust, which has elected to report as such and has filed its return in the form and within the time provided in this act and the rules and regulations promulgated in connection therewith, shall,

in the case of an investment company, be measured by 25% of its entire net income and 25% of its entire net worth, and in the case of a real estate investment trust, by 4% of its entire net income and 15% of its entire net worth, at the rates hereinbefore set forth for the computation of tax on net income and net worth, respectively, but in no case less than $250.00, and further provided, however, that the franchise tax to be annually assessed to and paid by a regulated investment company which for a period covered by its report satisfies the requirements of Chapter 1, Subchapter M, Part I, Section 852 (a) of the Federal Internal Revenue Code shall be $250.00.

(e) The tax assessed to any taxpayer pursuant to this section shall not be less than $25.00 in the case of a domestic corporation, $50.00 in the case of a foreign corporation, or $250.00 in the case of an investment company or regulated investment company.

(f) In lieu of the portion of the tax based on net worth and to be computed under subsection (a) of this section, any taxpayer, the value of whose total assets everywhere, less reasonable reserves for depreciation, as of the close of the period covered by its report, amounts to less than $150,000.00, may elect to pay the tax shown in a table which shall be promulgated by the director.

§ 54:10A-6. Taxpayer maintaining regular place of business outside state

In the case of a taxpayer which maintains a regular place of business outside this State other than a statutory office, the portion of its entire net worth to be used as a measure of the tax imposed by section 5(a) of this act, and the portion of its entire net income to be used as a measure of the tax imposed by section 5(c) of this act, shall be determined by multiplying such entire net worth and entire net income, respectively, by an allocation factor which shall be the average of the fractions

computed in (A), (B) and (C) below, or of so many of them as may be applicable, that is:

(A) The average value of the taxpayer's real and tangible personal property within the State during the period covered by its report divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period; provided, however, that for the purpose of determining average value, the provisions with respect to depreciation as set forth in paragraph 2(F) of subsection (k) of section 4 of P.L. 1945, c. 162 (C. 54:10A-4) shall be taken into account for arriving at such value.

(B) The receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its net income for federal tax purposes, arising during such period from

(1) sales of its tangible personal property located within this State at the time of the receipt of or appropriation to the orders where shipments are made to points within this State,

(2) sales of tangible personal property located without the State at the time of the receipt of or appropriation to the orders where shipment is made to points within the State,

(3) (Deleted by amendment.)

(4) services performed within the State,

(5) rentals from property situated, and royalties from the use of patents or copyrights, within the State,

(6) all other business receipts (excluding dividends excluded from entire net income by subsection (k)(1) of section 4 hereof) earned within the State, divided by the total amount of the taxpayer's

receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business receipts, whether within or without the State.

For the purposes of this section, receipts shall not include any sum or sums of money received in payment for gas or electric energy sold to a public utility subject to taxation pursuant to P.L. 1940, c. 5 (C. 54:30A-49 et s   for resale to ratepayers of the public utility.

(C) The total wages, salaries and other personal service compensation, similarly computed, during such period of officers and employees within the State divided by the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's officers and employees within and without the State.

In the case of a taxpayer which does not maintain a regular place of business outside this State other than a statutory office, the allocation factor shall be 100%.

In the case of a banking corporation which maintains a regular place of business outside this State other than a statutory office, and which elects to take the exclusion from net worth provided in subsection (d) of section 4 of P.L. 1945, c. 162 (C. 54:10A-4) or the deduction from entire net income provided in subsection (k)(4) of section 4 of P.L. 1945, c. 162, the allocation factor shall be computed and applied in accordance with section 6 of P.L. 1945, c. 162 (C. 54:10A-6); provided, however, that the numerators and the denominators of the fractions described in section 6(A), 6(B) or 6(C) shall include all amounts attributable, directly or indirectly, to the production of the eligible net income of an international banking facility as defined in subsection (k)(4) of section 4 of P.L. 1945, c. 162, whether or not such amounts are otherwise attributable to this State.

CRUDE OIL WINDFALL PROFIT TAX OF 1980,
I.R.C. §§ 4986 *et seq.*

SEC. 4986. IMPOSITION OF TAX.

(a) IMPOSITION OF TAX.—An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period.

(b) TAX PAID BY PRODUCER.—The tax imposed by this section shall be paid by the producer of the crude oil.

SEC. 4987. AMOUNT OF TAX.

(a) IN GENERAL.—The amount of tax imposed by Section 4986 with respect to any barrel of taxable crude oil shall be the applicable percentage of the windfall profit on such barrel.

* * * *

SEC. 4988. WINDFALL PROFIT; REMOVAL PRICE.

(a) GENERAL RULE.—For purposes of this chapter, the term "windfall profit" means the excess of the removal price of the barrel of crude oil over the sum of—

(1) the adjusted base price of such barrel, and

(2) the amount of the severance tax adjustment with respect to such barrel provided by section 4996(c).

(b) NET INCOME LIMITATION ON WINDFALL PROFIT.—

(1) IN GENERAL.—The windfall profit on any barrel of crude oil shall not exceed 90 percent of the net income attributable to such barrel.

(2) DETERMINATION OF NET INCOME.—For purposes of paragraph (1), the net income attributable to a barrel shall be determined by dividing—

(A) the taxable income from the property for the taxable year attributable to taxable crude oil, by

(B) the number of barrels of taxable crude oil from such property taken into account for such taxable year.

(3) Taxable income from the property.—For purposes of this subsection—

(A) In general.—Except as otherwise provided in this paragraph, the taxable income from the property shall be determined under section 613(a).

* * * *

(c) Removal Price.—For purpose of this chapter—

(1) In general.—Except as otherwise provided in this subsection, the term "removal price" means the amount for which the barrel is sold.

(2) Sales between related persons.—In the case of a sale between related persons (within the meaning of section 144(a)(3)), the removal price shall not be less than the constructive sales price for purposes of determining gross income from the property under section 613.

(3) Oil removed from premises before sale.—If crude oil is removed from the premises before it is sold, the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

(4) Refining begun on premises.—If the manufacture or conversion of crude oil into refined products begins before such oil is removed from the premises—

(A) such oil shall be treated as removed on the day such manufacture or conversion begins, and

(B) the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

(5) Meaning of terms.—The terms "premises" and "refined product" have the same meaning as when used for purposes of determining gross income from the property under section 613.

SEC. 4989. ADJUSTED BASE PRICE.

(a) Adjusted Base Price Defined.—For purposes of this chapter, the term "adjusted base price" means the base price for the barrel of crude oil plus an amount equal to—

(1) such base price, multiplied by

(2) the inflation adjustment for the calendar quarter in which the crude oil is removed from the premises.

The amount determined under the preceding sentence shall be rounded to the nearest cent.

(b) Inflation Adjustment.—

(1) In general.—For purposes of subsection (a), the inflation adjustment for any calendar quarter is the percentage by which—

(A) the implicit price deflator for the gross national product for the second preceding calendar quarter, exceeds

(B) such deflator for the calendar quarter ending June 30, 1979.

* * * *

(c) Base Price for Tier 1 Oil.—For purposes of this chapter, the base price for tier 1 oil is—

(1) the ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, reduced by

(2) 21 cents.

(d) BASE PRICES FOR TIER 2 OIL AND TIER 3 OIL.—For purposes of this chapter—

(1) GENERAL RULE.—Except as provided in paragraph (2), the base prices for tier 2 oil and tier 3 oil shall be prices determined pursuant to the method prescribed by the Secretary by regulations. Any method so prescribed shall be designed so as to yield, with respect to oil of any grade, quality, and field, a base price which approximates the price at which such oil would have sold in December 1979 if—

(A) all domestic crude oil were uncontrolled, and

(B) the average removal price for all domestic crude oil (other than Sadlerochit oil) were—

(i) $15.20 a barrel for purposes of determining base prices for tier 2 oil, and

(ii) $16.55 a barrel for purposes of determining base prices for tier 3 oil.

* * * *

SEC. 4991. TAXABLE CRUDE OIL; CATEGORIES OF OIL.

(a) TAXABLE CRUDE OIL.—For purposes of this chapter, the term "taxable crude oil" means all domestic crude oil other than exempt oil.

* * * *

(c) TIER 1 OIL.—For purposes of this chapter, the term "tier 1 oil" means any taxable crude oil other than—

(1) tier 2 oil, and

(2) tier 3 oil.

(d) TIER 2 OIL.—For purposes of this chapter—

(1) IN GENERAL.—Except as provided in paragraph (2), the term "tier 2 oil" means—

(A) any oil which is from a stripper well property within the meaning of the June 1979 energy regulations, and

(B) any oil from an economic interest in a Naval Petroleum Reserve held by the United States.

(2) EXCLUSION OF CERTAIN OIL.—The term "tier 2 oil" does not include tier 3 oil.

(e) TIER 3 OIL.—For purposes of this chapter—

(1) IN GENERAL.—The term "tier 3 oil" means—

(A) newly discovered oil,

(B) heavy oil, and

(C) incremental tertiary oil.

* * * *

SEC. 4996. OTHER DEFINITIONS AND SPECIAL RULES.

* * * *

(c) SEVERANCE TAX ADJUSTMENT.—For purposes of this chapter—

(1) IN GENERAL.—The severance tax adjustment with respect to any barrel of crude oil shall be the amount by which—

(A) any severance tax imposed with respect to such barrel, exceeds

(B) the severance tax which would have been imposed if the barrel had been valued at its adjusted base price.

(2) SEVERANCE TAX DEFINED.—For purposes of this subsection, the term "severance tax" means a tax—

(A) imposed by a State with respect to the extraction of oil, and

(B) determined on the basis of the gross value of the extracted oil.

(3) LIMITATIONS.—

(A) 15 PERCENT LIMITATION.—A severance tax shall not be taken into account to the extent that the rate thereof exceeds 15 percent.

(B) INCREASES AFTER MARCH 31, 1979, MUST APPLY EQUALLY.—The amount of the severance tax taken into account under paragraph (1) shall not exceed the amount which would have been imposed under a State severance tax in effect on March 31, 1979, unless such excess is attributable to an increase in the rate of the severance tax (or to the imposition of a severance tax) which applies equally to all portions of the gross value of each barrel of oil subject to such tax.

* * * *

(f) ADJUSTMENT OF REMOVAL PRICE.—In determining the removal price of oil from a property in the case of any transaction, the Secretary may adjust the removal price to reflect clearly the fair market value of oil removed.

* * * *

APPENDIX I

STATEMENTS PURSUANT TO RULE 28.1

AMERADA HESS CORPORATION

Alpetco (U.K.) Ltd.
Amerada Hess El Qa Corporation
Anglomar Shipping Company Ltd.
Ariadne Co. L.P.
Artemis Marine Co. L.P.
Atlas Marine Co.
Conmar Terminals, Ltd.
Esperanza Petroleum Corporation
First United Shipping Corp.
Granreunion Co.
Interocean Tanker Corp.
Matco Tankers (U.K.) Ltd.
Meadville Corporation
Minas y Petroleos Del Ecuador
Oasis Oil Company of Libya, Inc.
Petroleos Yasuni, C.A.
Pict Petroleum Plc
Second United Shipping Corp.
Solar Gas, Inc.
South Jersey Terminal Corp.
St. Croix Petrochemical Corp.
St. Lucia Road Contractors
Third United Shipping Corp.
(formerly Lion Tankers, Ltd.)
Williams Fisher Hess Co., Ltd.
Wyatt, Inc.

ATLANTIC RICHFIELD COMPANY

ABE Beverage, Inc.
Agro Internacional, S. de R.L. de C.V.
Almeg Extrusion Company, Inc.
Alyeska Pipeline Service Company
Ambler Mining Company
Anaconda Exploration New Zealand Limited
Anamax Mining Company
Anamet, S.A. de C.V.
ARCO Chemical IBERICA, S.A.
ARCO Oil Limited
ARCO Solar Nigeria, Ltd.
Arpet Petroleum Limited
A/S Skaland Graftiverk
Atlantic Richfield Oil Limited
Atlantic Richfield de Mexico, S.A. de C.V.
Badger Pipeline Company
Black Lake Pipe Line Company
Blair Athol Coal Pty., Limited
Candel International, Limited
Caribou-Chaleur Bay Mines Ltd.
Caribou-Smith Mines Ltd.
Centroamerica de Cobre, S.A.
Cobre de Hercules, S.A.
Cobre de Mexico, S.A.
Cobrecel, S.A. de C.V.
Colonial Pipeline Company
Compania Minera Dos Republicas S.A. de C.V.
Compania Minera Kappa, S.A.
Compania Minera Penacobre, S.A.
Compania de Petroleo Ganso Azul, Ltda.
Cook Inlet Pipe Line Company
Cupro San Luis, S.A. de C.V.
Delaware Bay Transportation Company
Dexter de Mexico, S.A.
Dixie Pipeline Company
East Texas Salt Water Disposal Co.

85819 Canada Limited
Eisenhower Mining Company
Empresa de Comercio Exterior Mexicano, S.A. de C.V.
Ericsson
Flower Street Limited
Gravity Adjustment, Inc.
Greater Pacific Limited
Imperial Eastman de Mexico, S.A.
Impulsora De Cobre, S.A. de C.V.
Industrias Nacobre, S.A. de C.V.
Industrias Tecnos, S.A. de C.V.
Iricon Agency Ltd.
Kenai Pipe Line Company
Kronos, Computacion y Teleproceso, S.A. de C.V.
Kuparuk Transportation Capital Corporation
Kuparuk Transportation Company
Las Quintas Serenas Water Company
Lavan Petroleum Co.
Lingobronce, S.A.
Manufacurera Mexicana De Partes Para Automoviles, S.A. de C.V.
Mayflower Mining Company
Minera Anaconda Limitada
Montoro, Empresa Para La Industria Quimica
Nacional de Cobre, S.A.
Nihon Oxirane Company, Ltd.
Nordisk Mineselskab A/S
Oxirane Technology (Japan) Company
P.T. Arutmin Indoensia
P.T. Elnusa Chemlink
Park City Ventures
Park-Cummings Mining Company
Park-Premier Mining Company
Participaciones Mexicanas, S.A. de C.V.
Platte Pipe Line Company
Prince Consolidated Mining Company
Productos Especiales Metalicos, S.A.
Richfield U.K. Petroleum, Limited

Rodman, Inc.
Servicios Industriales Nacobre, S.A.
Sinclair (U.K.) Oil Company Limited
Sinclair Venezuelan Oil Company
Smoke House Copper Mining Company
Sociedade Anonima Marvin
Solvanmex, S.A. de C.V.
SUMIARCO Company Limited
Swecomex, S.A.
Tecumseh Pipe Line Company
Texas-New Mexico Pipe Line Company
Tubos Flexibles, S.A.
Union de Credito Industrial Vallejo, S.A.
West Mayflower Mining Company
William Prym de Mexico, S.A.

CHEVRON U.S.A. INC./GULF OIL CORPORATION *

American Overseas Petroleum Limited
    American Overseas Petroleum (Spain) Limited
Arabian Chevron Overseas Limited
Arabian Chevron, Inc.
AMAX Inc.

Bahama California Oil Company
Belize Chevron Oil Company
California (Nigeria), Incorporated
    Chevron Oil Company (Nigeria)
California Asiatic Oil Company
    Chevron Darajat Limited
    Chevron Jambi Inc.
    Chevron Langsa Inc.
    Chevron Natuna Inc.
    Chevron Nauka Inc.
    Chevron Oil Company (Nigeria)
    Chevron Oil Company of Spain
    Chevron Singkarak Inc.
California Ecuador Petroleum Company
Caltex Petroleum Corporation
Chevron do Brasil Participacoes e Empreendimentos Ltda.
Chevron Amazon Petroleum Company
Chevron Australia Transport Pty., Ltd.
    Northwest Shelf Shipping Service Company Pty. Ltd.
Chevron Bahia Petroleum Company
Chevron Bahia Sul Petroleum Company
Chevron Canada Limited
    Chevron Canada Resources Limited
        Chevron Canada Petroleum Limited
        Glen Park Gas Pipeline Company Limited
        Rimbey Pipe Line Co. Ltd.
        Standard Development Company Limited
        Sultran Ltd.

* Chevron U.S.A. Inc. and Gulf Oil Corporation were merged after the commencement of this litigation.

Chevron Minerals Limited
Cornwallis Arctic Oils Limited
Furnace Oil Sales Ltd.
Irving Oil Company, Limited
Irving Oil Limited
Canaport Limited
Irving California Oil Company Ltd.
Irving Oil Terminals Ltd.
Irving Oil Limited
Canaport Limited
Irving California Oil Company Ltd.
Irving Oil Terminals Ltd.
Standard Oil Company of British Columbia (1981) Limited
Chevron Coal Development Company
Chevron Corporation
Chevron Environmental Health Center, Inc.
Chevron Exploration Corporation
Chevron Exploration Corporation of Chile
Chevron Exploration Corporation of Sudan
Chevron Foreign Service Corporation
Chevron Guaratuba Petroleum Company
Chevron Iguape Petroleum Company
Chevron Indonesia Oil Company
Chevron Industries, Inc.
Chevron Mineral Corporation of Ireland
Chevron International Oil Company, Inc.
A/S Hydrantanlaegget Koebenhavns Lufthavn, Kastrup
Aircraft Fuel Supply B.V.
Chevron Belgium Refining
Chevron Erdoel Handels G.m.b.H.
Caltex Deutschland G.m.b.H.
Chevron Functional Fluids, Inc.
Chevron International Services, Inc.
Chevron International Trading Company—West Africa

Chevron Italiana Marina Aviazione S.p.A.
MARS—Milan Airport Refuelling Services S.p.A.
SERAM—S.p.A.
Chevron Oil (Switzerland)
Mittelland Refinery Limited
SARACO S.A.
TAR—Tankanlage Ruemlang A.G.
UBAG—Unterflurbetankungsanlage Flughafen Zurich
Chevron Oil Latin America, Inc.
Chevron Oil Trading Company
Maasvlakte Olie Terminal N.V.
Rotterdam-Antwerpen Pijpleiding (Belgie) N.V.
Rotterdam-Antwerpen Pijpleiding (Nederland) N.V.
Sunset Oil Trading Limited
Chevron Itajai Petroleum Company
Chevron Land and Development Company
C-W Properties, Inc.
Glenwood Properties
Ontario Center, The
Pacific Coast Homes
Sepulveda Properties, Inc.
Chevron Maranhao Petroleum Company
Chevron Maritime Transport Corporation
Chevron Mineral Corporation of Ireland
Chevron Natural Gas Services, Inc.
Chevron Nile Services Limited
Chevron Oceanic, Inc.
Arabian American Oil Company
Aramco Overseas Company
Aramco Services Company
Trans-Arabian Pipe Line Company
Arabian Chevron Trading Company
Associated Octel Company Limited, The
A.K. Chemie G.m.b.H.
Associated Octel Company (Plant) Limited

Associated Octel Company (South Africa) (Proprietary) L
Octel Societe Anonyme
Societa Italiana Additivi per Carburanti SpA (S.I.A.C.)
Societe Octel-Kuhlmann
Caltex Mediterranean Limited
Chevron Capital N.V.
Chevron Oceanic (Middle East), Inc.
Chevron Oil and Chemical Company AB
Chevron Oil Company of The Netherlands
Gulf Oil (Nederland) Exploration and Production Company
Chevron Oil Service Company
Chevron International Oil Company Limited
Hydrant Servicing Company Limited
Quotegem Limited
United Kingdom Oil Pipelines Limited
Chevron Oil (Ireland) Limited
Chevron Petroleum (U.K.) Limited
British Kewanee, Inc.
Kewanee Oil Company (U.K.) Limited
Chevron Exploration North Sea Limited
Chevron Petroleum Company Limited
Chevron Oil, Sociedad Anonima
Eastern Transport Corporation
N.V. Rotterdam-Rijn Pijpleiding Maatschappij
Chevron Oil & Chemical Company Pty. Ltd.
Chevron Oil and Chemical Company Limited
Chevron Oil and Chemical Company Oy
Chevron Oil Company (Ghana)
Chevron Oil Company of Central African Republic
Chevron Oil Company of Chad
Societe d'Etude et d'Exploitation de la Raffinerie du Tch
Chevron Oil Company of Egypt
Chevron Oil Company of Equatorial Guinea
Chevron Oil Company of Ethiopia

Chevron Oil Company of Gabon
Chevron Oil Company of Germany
Chevron Oil Company of India
Chevron Oil Company of Ireland
Chevron Oil Company of Italy S.p.A.
Chevron Oil Company of Japan
Chevron Oil Company of Kenya
Chevron Oil Company of Korea
Chevron Oil Company of Liberia
Chevron Oil Company of Madagascar
Chevron Oil Company of Mauritius
Chevron Oil Company of Morocco
Chevron Oil Company of Niger
Chevron Oil Company of Portugal
Chevron Oil Company of Senegal
Chevron Oil Company of South Africa
Chevron Oil Company of South West Africa
Chevron Oil Company of Sudan
Chevron Oil Company of Syria
Chevron Oil Company of Thailand
Chevron Oil Company of The Gambia
Chevron Oil Company of The Philippines
Chevron Oil Company of Uruguay
Chevron Oil Company of Yugoslavia
Chevron Oil Company of Yugoslavia (Jabuka)
Chevron Oil Company of Yugoslavia (Mljet)
Chevron Oil Exploration Company of Greece
Chevron Oil Field Research Company
Chevron Orient, Inc.
Chevron Overseas Finance Company
Chevron Oil Company of Venezuela
Tierras e Inversiones Venezuela, C.A.
Compania Petrolera Chevron, Ltd.
Chevron Overseas Petroleum Inc.
Chevron Petroleum Company of Brazil
Chevron Petroleum Company of Colombia
Chevron Petroleum Company of Greenland
Chevron Petroleum Company of Norway

Chevron Petroleum Norge A/S
Chevron Pipe Line Company
    Chevron Alaska Pipe Line Company
    Chevron Raven Ridge Pipe Line Company
Chevron Porto Belo Petroleum Company
Chevron Research Company
    B.V. Chevron Centrale Laboratoria
    Chevron do Brasil Ltda.
    Chevron Research Company (Japan) Ltd.
Chevron Sao Luis Petroleum Company
Chevron Sao Marcos Petroleum Company
Chevron Shale Oil Company
Chevron Shipping Company
Chevron Solemar Petroleum Company
Chevron Standard Limited
    Chevron Canada Resources Limited
        Chevron Canada Petroleum Limited
        Glen Park Gas Pipeline Company Limited
        Rimbey Pipe Line Co. Ltd.
        Standard Development Company Limited
        Sultran Ltd.
Chevron Stations, Inc.
Chevron Tankers (Nederland) B.V.
Chevron Telecommunications Company
Chevron U.S.A. Inc.
    American Gilsonite Company
    American Personnel Services Inc.
    Argentine Gulf Oil Company
    Atlas Supply Company
    Australian Gulf Oil Company
    Bolivian Gulf Oil Company
    Cabinda Gulf Oil Company
        Cabina Gulf Oil Company Limited
    California Company, The
    Canyon Reef Carriers, Inc.
    Chandeleur Pipe Line Company
    Chevron Capital U.S.A. Inc.

Chevron Chemical Company
    Aditivos Mexicanos, S.A. de C.V.
    Chevron do Brasil Ltda.
    Chevron Chemical (Canada) Limited
        Cansulex Limited
        Later Chemicals Limited
    Chevron Chemical (Far East) Private Limited
    Chevron Chemical Company S.A.F.
        Deutsche Ortho G.m.b.H.
    Chevron Chemical International Sales, Inc.
    Chevron Chemical International, Inc.
    Chevron Chemical, S.A.
        Chevron Chemical G.m.b.H
    Chevron International Chemicals Inc.
    Chevron International Chemicals Ltd.
    Coromandel Fertilisers Limited
    Crediton Enterprises, Inc.
    Gulf Chemicals International, Inc.
        Plastigama S.A.
    Gulf Doric Western Corporation
    Harshaw Chemical Company, The
    Insecticidas Ortho, S.A.
    Internacional de Basicos y Quimicos, S.A. de C.V.
    Karonite Chemical Company, Limited
    Nippon Petroleum Detergent Company, Limited
    Orogil, S.A.
    Penrith Enterprises, Inc.
    Petrosynthese S.A.
    Quimicas Ortho De California, Limitada
    Ripon Enterprises, Inc.
    Spirolite Corporation
Chevron Geothermal Company of California
Chevron Investment Management Company
Chevron Italia Oil Company S.p.A.
Chevron Oil Finance Company
Chevron Petroleum Company of The Netherlands
Chevron Sulawesi Inc.

- Chevron Travel Club, Inc.
    - Chevron Travel Club Services Company
- CLP Corporation
- Dixie Pipeline Company
- Douala Gulf Oil Company
- Ecuadorian Gulf Oil Company
- Explorer Pipeline Company
- Federal Engineering Corporation
    - Compania Comercial Chevron, S.A.
- Felix Oil Company
- Gulf Agricultural Chemicals Company Limited
    - Gulf (U.K.) Offshore Investments Limited
    - Gulf Oil (Great Britain) Limited
        - Gulf Oil North Sea Limited
        - Gulf Oil Refining Limited
            - London Oil Refining Co. Limited, The
        - London Oil Refining Co. Limited, The
            - Lorco Oils (North) Limited
        - Lorco Oils (North) Limited
    - Gulf Oil (U.K.) Limited
    - Gulf Oil Zaire S.A.R.L.
- Gulf Asian Investments Company Limited
- Gulf Auto Club, Inc.
- Gulf Offshore Cameroon Company
- Gulf Oil Communications Company, Inc.
- Gulf Oil Company of Cameroon
- Gulf Oil Company of Gabon
- Gulf Oil Company-Eastern Hemisphere
- Gulf Oil Germany Inc.
- Gulf Oil Realty Company
    - Gulf Reston Properties, Inc.
- Gulf Research & Development Company
    - Gulf Oil Company (Nigeria) Limited
    - Gulf Oil Zaire S.A.R.L.
    - Plaschem International Co. (Hong Kong) Limited
- Gulf West Cameroon Exploration Company
- Intermountain Geothermal Company

- International Bitumen Emulsions Corporation
- Kenai Pipe Line Company
- Kewanee Industries, Inc.
    - Kewanee Overseas Oil Company
    - Netherlands Kewanee, Inc.
- Long Beach Oil Development Company
- Mid-Valley Pipeline Company
- Murvale Company
- Norske Gulf Production Company A/S
- Paloma Pipe Line Company
- Pembroke Capital Company Inc.
- Petroleum Facilities, Inc.
- Pittsburg & Midway Coal Mining Co., The
    - Solvent Refined Coal International, Inc.
- Plantation Pipe Line Company
- Platte Pipe Line Company
- Powell Bend Mining Co.
- South Pacific Gulf Oil Company
- Standard Gas Company
- Standard Gasoline Company
- Standard Oil Company
- Standard Oil Company of Texas, Inc.
- Standard Pacific Gas Line Incorporated
- Standard Pipe Line Company
- Suriname Gulf Oil Company
- Transocean Group, Inc.
    - Transinsco, Inc.
- Transocean Gulf Oil Company
    - Bermaco Insurance Company Limited
        - Insco Limited
            - Britamco Limited
            - Cayman Kewanee Limited
    - Caribbean Gulf Refining Corporation
    - Chevron Caribbean Investments Inc.
    - Chevron International Limited
        - Balinesian Gulf Oil Limited
        - Chevron Barreirinhas Exploration Limited
            - Chevron Servicos de Petroleo Ltda.

Chevron International (Argentina) Limited
Chevron International (Malaysia) Limited
Chevron International Italy Limited
Chevron International Somalia Limited
Chevron International Yugoslavia Limited
Chevron LNG Shipping Company Limited
International Gas Transportation Company Limited
Chevron Transport Corporation
Chevron Product Carriers Corporation
Gulf Fujairah Petroleum Limited
Gulf Musandam Petroleum, Limited
Gulf Oil (Ireland) Limited
Gulf Oil of Colombia Limited
Gulf Oil Australia Pty. Ltd.
Gulf Oil Egypt Limited
Gulf Oil Pakistan Limited
Gulf Oil Ras Al-Khaimah Limited
Gulf Oil Shadwan Limited
Gulf Oil Suez Limited
Gulf Oil Terminals (Ierland) Limited
Britama Tankers Limited
Gulf Oman Petroleum Limited
Kupan International Company Pension Plan Trustees L
Natuna Gulf Oil Limited
New Frontiers Limited
Niugini Gulf Oil Pty. Limited
Sumatra Gulf Oil, Limited
Tunisian Gulf Exploration and Production Company
Chevron Marine and Services Company Limited
Chevron Transport Corporation
Chevron Product Carriers Corporation
Eastern Gulf Oil Company Limited
Britama Tankers Limited
Global Energy Operations and Management Company, Ltd.

Gulf (U.K.) Offshore Investments Limited
Gulf U.K. Offshore Exploration Company Limited
Gulf Asian Investments Company Limited
Gulf Kuwait Company
Burgan Pension Fund Trustees Limited
Kuwait Oil Company Limited
Burgan Pension Fund Trustees Limited
Kuwait Oil Company Trustees Limited
Kuwait Oil Company Trustees Limited
Gulf Oil (Ireland) Limited
Gulf Oil (U.K.) Limited
Britama Tankers Limited
Chevron Chemical U.K. Limited
Gaelic Oil Company Limited, The
Gulf International Trading Company (Europe) Limited
Gulf Oil (Great Britain) Limited
Gulf Oil North Sea Limited
London Oil Refining Co. Limited, The
Gulf Oil Refining Limited
Lorco Oils (North) Limited
London Oil Refining Co. Limited, The
Lorco Oils (North) Limited
Gulf Oil Financial Services Company Limited
Chevron Chemical U.K. Limited
Gulf Oil Terminals (Ireland) Limited
Kewanee Oil Company (U.K.) Limited
Silvertown Lubricants Limited
Gaelic Oil Company Limited, The
Gulf International Trading Company (Europe) Limited
Chevron Chemical U.K. Limited
Gulf Oil Financial Services Company Limited
Gulf Oil Refining Limited

Gulf Oil Company (Nigeria) Limited
Gulf Oil Finance N.V.
Gulf Oil Services, Inc.
Gulf Oil Zaire S.A.R.L.
Gulf U.K. Offshore Exploration Company Limited
Iranian Oil Participants Limited
Iranian Oil Services (Holdings) Limited
Mene Grande Oil Company
Norwegian Gulf Exploration Company A/S
Plaschem International Co. (Hong Kong) Limited
Venezuela Gulf Refining Company
Warren Petroleum, Inc.
West Texas Gulf Pipe Line Company
Western States Geothermal Company
Zaire Gulf Oil Company
Gulf Oil Zaire S.A.R.L.
Chevron Ubatuba Petroleum Company
Chevron Venezuela Services Inc.
Compania de Petroleo Chevron S.A.
Compania Comercial California S.A.
Compania Comercial Conchan S.A.
Cobpania Minera Chevron de Espana, S.A.
Compania Minera Chevron, Inc.
Compania Petrolera Chevron
Compania Petrolera Chevron Guatemala
Compania Petrolera Chevron Honduras
Compania Petrolera Chevron Nicaragua
Compania Petrolera Chevron, Inc.
Cornwallis Arctic Oils Limited
Crest Exploration Limited

Dominion Oil Limited

Far Eastern Petroleum Company Limited
Chevron Overseas Petroleum Limited
BORCO Towing Company Limited
Freeport Trading Company Limited

Marine Agents and Brokers Limited
Overseas Petroleum Company Limited
BORCO Towing Company Limited
Freeport Trading Company Limited
Marine Agents and Brokers Limited
River Nile Petroleum Company Limited
White Nile Petroleum Company Limited

Gasolinas Chevron de Puerto Rico Inc.
Gulf Oil Corporation

Huntington Beach Company
Huntington Pacific Corporation
Huntington Seacliff Corporation
Mansion Properties, Inc.

Iran Chevron Oil Company
Iranian Oil Participants Limited
Iranian Oil Services (Holdings) Limited

Kelmac, Inc.
Ukamar Limited

Oil Insurance Limited
Oil Investment Corporation Ltd.
Oil Investment Corporation Ltd.

P. T. Caltex Pacific Indonesia
Pacific Oil Company
Petroleum Buildings, Inc.

Refineria Petrolera de Guatemala-California, Inc.

Standard Oil Company
Standard Oil Company of California
Standard Oil Company of Delaware
Standard Oil Company, Inc.
Standard Oil Company, Ltd.
Standard Oil Sales Co., Inc.

UNC Incorporated

Western Company, The
Western Transnav Company

CITIES SERVICE COMPANY

(Now CanadianOxy Offshore Production Co.)

Diamond Shamrock Italia, S.p.A.—Italy
Beatrice Pocahontas Company—Delaware
Canadian Occidential Petroleum Ltd.—Canada (Dominion)
Carbocloro S.A. Industrias Quimicas—Brazil
Church & Dwight Co., Inc.—Delaware
Citco Union Texas Petroleo de Brasil Ltda.—Brazil
Diamond Shamrock Chemicals Company Pty. Limited—Australia
Diamond Shamrock de Chile S.A.I.—Chile
Distribuidora y Exportadora Udylite, S.A.—Mexico
Dixie Pipeline Company—Delaware
East Texas Salt Water Disposal Company—Texas
Eko Hotels Limited—Nigeria
Enoxy Coal, Inc.—Delaware
Enoxy Holding, Inc.—Delaware
Excel de Mexico, S.A. de C.V.—Mexico
Hazox Corporation
Hispano Inversion, S.A.—Spain
Hybrid Rice, Inc.—Delaware
Industria Quimica de Portuguesa, S.A.—Venezuela
Industrias Oxy S.A. de C.V.—Mexico
International Ore & Fertilizer Belgium, S.A.—Belgium
Intragas Management B.V.—Netherlands
Island Creek of China Coal Ltd.—Bermuda
Korea Potassium Chemical Co., Ltd.—Korea
Malharia Industrial do Nordeste S.A. ("Malharia")—Brazil
Minera Azteca, S.A. de C.V.—Mexico
Mississippi Chemical Corporation—Mississippi
Numinter Limited—United Kingdom
Occidental Chemical China Limited—Hong King
Occidental Chemical Far East Limited—Hong Kong
Occidental de Espana, S.A.—Spain

Occiental Petroleum Corporation
Oil Casualty Insurance, Ltd.—Bermuda
Oxy Metal Industries (France) S.A.—France
OXYTECH Systems, Inc.—Delaware
Palo Duro Pipeline Company, Inc.—Delaware
Petway Products Distributors, Inc.—New York
Plasticos y Derivados Compania Anonima—Venezuela
Plastiflex, C.A.—Venezuela
Rail to Water Transfer Corporation—Delaware
RAMM Hybrids, Inc.—Delaware
RAMM Hybrids International, Inc.—Japan
Sumitomo Durez Co., Ltd.—Japan
Thai Diamond Shamrock Chrome Limited—Thailand
Thai Diamond Shamrock, Ltd.—Thailand
Tororo Industrial Chemicals and Fertilizers Limited—Uganda
Trans-Jeff Chemical Corporation—Delaware
602 Operating Corporation—Delaware
Rose Creek Vangorda Mines Ltd.
Petrogas Processing Ltd.
Blake Resources Ltd.
Sultran Ltd.
Cansulex Limited
Cynthia Gas Gathering Company Limited
Syncrude Canada Ltd.
Northward Developments Ltd.
Nova, an Alberta Corporation
Nottingham Gas Limited

CONOCO INC.

E. I. du Pont de Nemours and Company
Conoco Delaware, Inc.
Big Sky of Montana Realty, Inc.
Cit-Con Oil Corporation
Conch International Methane Ltd.
Felix Oil Company
Jupiter Chemicals, Inc.
Kettleman North Dome Assoc.
Long Beach Oil Development Company
Oberrheinische Mineraloelwerke GmbH (OMW)
Petco Enterprises Ltd.
Petrocokes Ltd.
Petrocokes Terminals, Inc.
Southern Facilities, Inc.
The Standard Shale Products Company
Tidelands Royalty Trust

EXXON CORPORATION

Abu Dhabi Company for Onshore Oil Operations
Abu Dhabi Petroleum Company Limited
Ace Polymer Co., Ltd.
Aditivos Orinoco, C. A.
Adria-Wien Pipeline Gesellschaft mit beschrankter Haftung
Aircraft Fuel Supply B. V.
Aishin Sekiyu K. K.
Alberta Products Pipe Line Ltd.
Al-Jubail Petrochemical Company
Altona Petrochemical Company Limited
Alyeska Pipeline Service Company
Andian National Corporation, Limited
Arabian American Oil Company
Aramco Overseas Company
Aramco Services Company
A/S Futurum
Asakawa Sekiyu K.K.
Asociacion Civil "Academy La Castellana"
Atlas Supply Company
Atlas Supply Company of Canada Limited
Australian Synthetic Rubber Company Limited
Aviation Services Saudi Arabia Limited
Awaji Gas Nenryo Kabushiki Kaisha
Azuma Sekiyu K.K.
BEB Erdgas and Erdol GmbH, Hannover
B.W.O.C., Inc.
Bangkok Aviation Fuel Services Limited
Banshu Ekika Gas K. K.
Bayerische Erdgasleitung G.m.b.H.
Beaverhill Resources Limited
Bel-Air Entreposage S. A.
BRIGITTA Erdgas und Erdol GmbH, Hannover
Bryan Woodbine Gathering Inc.
Building Products of Canada Limited
Byron Creek Collieries (1983) Limited

Carlew Inc.
Carnduff Gas Limited
Cary Chemicals Inc.
Castle Peak Power Company Limited
Champlain Oil Products Limited
Changi Airport Fuel Hydrant Installation Pte. Ltd.
Chuo Sekiyu Hanbai K.K.
Commercial Polymers Pty. Ltd.
Compagnie d'Etancheite Africaine en Cote d'Ivoire S. A.
Compania Minera Disputada de Las Condes S.A.
Comptoir Auxiliaire du Petrole
Comptoir Oxonnaxien des Combustibles (C.O.C.)
Computer Centrum Groningen B.V.
DFTG Deutsche Flussigerdgas Terminal GmbH
D.O.C. Dutch Offshore Consortium B.V.
Daihatsu Sekiyu K.K.
Daiichi Kouyu K. K.
Daitsu Sangyo K.K.
Demulsificantes Del Orinoco, C.A.
Depot Petrolier du Gresivaudan
Depots de Petrole Cotiers
Depots Petrolier de la Corse
Deudan-Holding GmbH
Deutsche Erdgas Transport G.m.b.H.
Deutsche Transalpine Oelleitung G.m.b.H.
Devon Estates Limited
Dixie Pipeline Company
Dukhan Service Company
E S F Limited
Eagle Kenso K.K.
East Japan Oil Development Company, Limited
East Texas Salt Water Disposal Company
Eastcoast Spill Response Inc.
Eiko Sekiyu K.K.
Elwerath Erdgas und Erdol GmbH, Hannover
Elwerath Erdol und Erdgas AG
Emirates Chemicals Company
Emori Sekiyu K.K.

Emsland-Erdolleitung G.m.b.H.
Energie Marketing Service GmbH (EMS)
Entrepot Petrolier de l'Aveyron (E.P.A.)
Entrepot Petrolier de Mulhouse (E.P.M.)
Erdgas-Verkaufs-Gesellschaft m.b.H.
Escuela Las Morochas, C. A.
Esso Chemical Alberta Limited
Esso Energie G.I.E.
Esso Exploration and Production Angola Inc.
Esso Malaysia Berhad
Esso of Canada Limited
Esso Resources Canada Limited
Esso Societe Anonyme Francaise
Esso Standard Tunisie S. A.
Etablissements Cloarec
Exact Reisebyra A/S
Exxon Chemical Pakistan Limited
F. T. Giken Kabushiki Kaisha
Ferngas Nordbayern G.m.b.H.
Ferngas Salzgitter GmbH
Forjas de Colombia, S. A.
489061 Ontario Inc.
Fuji Kogyo K.K.
Gasunie Engineering B.V.
General Bussan K.K.
General Highway K.K.
General Petrochemical Industries Limited
General Sekiyu K.K.
General Sekiyu Okinawa Hanbai K.K.
General Sekiyu Overseas Ltd.
General Shipping Co. Ltd.
General Unyu Kabushiki Kaisha
Geobutane—Lavera
Gewerkschaft Brassert Erdol und Erdgas GmbH
Gewerkschaft Elwerath & Co. GmbH
Gewerkschaft Erdol-Raffinerie Deurag-Nerag
Gewerkschaft Gute Hoffnung Erdgas und Erdol GmbH
Gewerkschaft Kuchenberg Erdgas under Erdol GmbH

Goroku Seikyu K.K.
Grande Ecaille Land Company, Inc.
Groupement Immobilier Petrolier
Groupement Petrolier Aviation
Groupement Petrolier de Nantes
Groupement Petrolier du Finistere G.I.E.
Groupement pour l'Etude d'un Pipeline Bordeaux Toulouse
Hankyu Ferry K.K.
Hannoversche Erdolleitung G.m.b.H.
Hanshin Kyowa Seikyu K.K.
Hayakawa Sekiyu K.K.
Heinrich Schneider Spedition GmbH
Hiroshima General Gas Juten Kabushiki Kaisha
Hoei Sekiyu K.K.
Hokushin Bussan K.K.
Hokuyu Sekiyu K. K.
Home Oil Company Limited
Houston Regional Monitoring Corporation
Hydranten-Betriebsgesellschaft
Hydrierwerke Poelitz Aktiengesellschaft
Imperial Oil Limited
Imperial Pipe Line Company, Limited, The
Inada Ekka Gas Kabushiki Kaisha
Industry Promotion Enterprises Limited
Interprovincial Pipe Line (Alberta) Ltd.
Interprovincial Pipe Line Limited
Interprovincial Pipe Line (NW) Ltd.
Iranian Oil Participants Limited
Iranian Oil Services (Holdings) Limited
Iranian Oil Services Limited
Iraq Petroleum Company, Limited
Iraq Petroleum Pensions, Limited
Japan Butyl Company Limited
Japan Coal Liquefaction Development Company, Ltd.
Jersey Nuclear-Avco Isotopes, Inc.
K.K. Aizu General
K.K. Daimaru
K.K. General Sekiyu Hanbaisho

K.K. Genetech
K.K. Heian Sekiyu
K.K. Kanagawa Sekiyu Shokai
K.K. Kyoei Shosha
K.K. Kyowa Sekiyu Service
K.K. Marugo Izumasa Shoten
K.K. Nippatsu
K.K. Standard Sekiyu Osaka Hatsubaisho
K.K. Toko
K.K. Toresen
K.K. Uwano Sekiyu Shokai
K/S Statfjord Transport A/S & Co.
Kabushiki Kaisha Sankyo Plastics
Kai Tak Refuellers Company Limited
Kanto Kygnus Sekiyu Hambai K.K.
Karlsruhe-Stuttgart Rohrleitung Gesellschaft mbH
Kawasaki Kygnus Sekiyu Hambai Kabushiki Kaisha
Keiyo Sekiyu Hanbai K.K.
Kenya Petroleum Refineries Limited
Kibo Sekiyu Hanbai K.K.
Kimura Sekiyu Kabushiki Kaisha
Kinwa Sekiyu K.K.
Kobe Port Service Kabushiki Kaisha
Kobe Standard Sekiyu K.K.
Kowa Sekiyu K.K.
Kowloon Electricity Supply Company Limited
Kygnus Ekka Gas Kabushiki Kaisha
Kygnus Kosan Kabushiki Kaisha
Kygnus Marketing Service K.K.
Kygnus Sekiyu K.K.
Kyushu Eagle K.K.
LPL Investments, Inc.
Lakehead Pipe Line Company, Inc.
LEAG Aktiengesellschaft fur luzernisches Erdol
Leco Inc.
Les Docks des Petroles d'Ambes
Limburgsche Maatschappij voor Gasdistributie Limagas N.V.

Long Beach Oil Development Company
Maasvlakte Olie Terminal N.V.
Maasvlakte Coal Terminal B.V.
Maatschappij voor Intercommunale Gasdistributie
Intergas N.V.
Maatschappij voor Intercommunale Gasvoorziening in
Oost-Brabant "OBRAGAS N.V."
Magota Sekiyu K.K.
Mainline Pipelines Limited
Maple Leaf Petroleum Limited
Maquinas de Coser y Bordar Sigma, S.A.
Marugo Gas K.K.
MEGAL FINCO
MEGAL GmbH
Meiji Sekiyu K.K.
MESBIC Financial Corporation of Houston
Metro Fuel Co. Ltd.
Mikawa Bussan K.K.
Mittelrheinische Erdgas Transport Gesellschaft mit
beschrankter Haftung
Montreal Pipe Line Limited/Les Pipe-Lines Montreal
Limitee
Mytex Polymers Incorporated
NAM—K 7 B.V.
NAM—K 14 B.V.
NAM—K 15 B.V.
NAM/CLOMS—K 8/K 11 B.V.
NAM/CLOMS—L 13 B.V.
N. V. Nederlandse Gasunie
NPC Services, Inc.
Nakabayashi Sekiyu K.K.
Nansei Oil Terminal K.K.
Nansei Sekiyu Kabushiki Kaisha
Native Venture Capital Co. Ltd.
Near East Development Corporation
Nederlandse Aardolie Maatschappij B. V.
Neptune Bulk Terminals (Canada) Ltd.
Nichimo Kabushiki Kaisha

Nichimo Oil (Bermuda) Co., Ltd.
Nichimo Sekiyu Seisei Kabushiki Kaisha
Nikko Sangyo K.K.
Nippon Unicar K.K.
Nisku Products Pipe Line Company Limited
Nissei Sekiyu Kabushiki Kaisha
Norddeutsche Erdgas-Aufbereitungs G.m.b.H.
Norddeutsche Mineraloelwerke Stettin G.m.b.H.
Norddeutsche Oelleitungs-gesellschaft m.b.H.
Nordrheinische Erdgas Transport Gesellschaft mit
beschrankter Haftung
Nord-West Oelleitung G.m.b.H.
Northward Developments Ltd.
Northwest Company, Limited
Nottingham Gas Limited
107580 Canada Inc.
139675 Canada Limited
151742 Canada Inc.
Office Prive d'Assurances et de Courtages
Offshore Medical Support Limited
Oil Field Chemicals Company (Saudi Arabia) Ltd.
Oil Service Company of Iran (Private Company)
Oil Spill Response Limited
Oil Transport Company (Saudi Arabia) Limited
Oldenburgische Erdol Gesellschaft m.b.H.
Osaka Ashyu Nenryou K.K.
Osaka Propane Gas Hambai Kabushiki Kaisha
Osaka Sekiyu Gas Yuso K. K.
P. T. Stanvac Indonesia
Pars Investment Corporation
Peninsula Electric Power Company Limited
Petroleum Refineries (Australia) Proprietary Limited
Petroleum Services (Middle East) Limited
Petrosvibri S.A.
Pinpoint Retail Systems Inc.
Pipe Line Services, Inc.
Plantation Pipe Line Company
Polder-Seehafen-Harburg GmbH

Portland Pipe Line Corporation
Primaer Oel GmbH
Progas A/S
Raffinerie du Midi S.A.R.L.
Rainbow Pipe Line Company, Ltd.
Redwater Water Disposal Company Limited
Refineria Petrolera Acajutla, S. A.
Renown Building Materials Limited
Rheingas Erdgasleitungs-Gesellschaft m.b.H.
Rochevert Inc.
Rotterdam Antwerpen Pijpleiding (Belgie)
Rotterdam-Antwerpen Pijpleiding (Nederland) N. V.
Ruhrgas Aktiengesellschaft
S.A. du Pipeline a Produits Petroliers sur Territoire Genevois (SAPPRO)
SEAG Aktiengesellschaft fur schweizerisches Erdol
S.O.P.—Societa Oleodotti Padani S. p. A.
Saitama Sekiyu Hanbai K.K.
Sakurajima Futo K.K.
Sanko Oil Kabushiki Kaisha
Sanyo Sekiyu K.K.
Saraco S. A.
Saudi Arabian Lube Additives Company Limited
Schubert KG
Scurry-Rainbow Oil Limited
Seibu Kygnus Sekiyu Hambai Kabushiki Kaisha
Seismic Industries A/S
Senpoku Oil Service K.K.
SERAM Societa per Azioni
Servacar Ltd.
Shehtah Drilling Limited
Shimoka Sekiyu Kabushiki Kaisha
Shimoyama Sekiyu K.K.
Shin-Nihon Yukagaku Kogyo K. K.
Shinohara Oil K.K.
Shizuoka Kanesho Hambai Kabushiki Kaisha
Smiley Gas Conservation Limited
Sociedad Anonima "Escuela Campo Alegre"

Sociedad de Inversiones de Aviacion
Sociedad Nacional de Oleoductos Ltda.
Societa Italiana per l'Oleodotto Transalpino S.p.A.
Societa per Azioni Raffineria Padana Olii Minerali-SARPOM
Societe Anonyme de la Raffinerie des Antilles
Societe Anonyme des Hydrocarbures
Societe Anonyme "Produits Lubrifiants de Madagascar"—PROLUMA S.A.
Societe Belge de Transport par Pipeline
Societe Civile de Mustapha Algerie
Societe Civile de Participation pour la Destruction des Dechets Industriels (SOCDI)
Societe Civile Immobiliere "Courcelles-Etoile"
Societe Civile Immobiliere de la Croix au Chene
Societe Civile Immobiliere due 195 Avenue de Neuilly
Societe Civile Immobiliere Khariessa
Societe Civile Immobiliere "Kleber-Etoile"
Societe Civile Immobiliere "Les Casseaux-Bougainville"
Societe de la Raffinerie d'Alger
Societe de la Raffinerie de Lorraine
Societe de Manutention de Carburants Aviation
Societe de Manutention de Carburants Aviation Dakar-Yoff, S.A.
Societe de Promotion et de Financement Touristique (CARTHAGO)
Societe d'Entreposage de San-Pedro
Societe des Pipe-Lines de Strasbourg
Societe des Transports Petroliers par Pipe Line
Societe d'Exploitation & de Developpement d'Operations Commerciales
Societe du Caoutchouc Butyl (SOCABU)
Societe du Pipe Line de la Raffinerie de Lorraine
Societe du Pipe-Line Mediterranee-Rhone
Societe du Pipeline Sud-Europeen
Societe Esso de Recherches et d'Exploitation Petrolieres Esso Rep
Societe Francaise Exxon Chemical
Societe "Geominés-Caen"

Societe Havraise de Manutention de Produits Petroliers
Societe Hoteliere de la Petite Campagne
Societe Immobiliere Paris-Niel
Societe Ivoirienne d'Operations Petrolieres S.A.
Societe Malgache de Raffinage
Societe Reunionnaise d'Entreposage
Socony-Standard-Vacuum Oil Company (Petroleum Maatschappij)
Southern Natural Gas Development Pty. Ltd.
Standard Kosan Kabushiki Kaisha
Standard Service K.K.
Statfjord Transport A/S
Stockage Geologique de Gaz de Lavera
Suddeutsche Erdgas Transport Gesellschaft mit beschrankter Haftung
Sun East Company Ltd.
Supertex, Inc.
Sydis, Inc.
Syncrude Canada Ltd.
Synergistics Industries Limited
System Plaza Kabushiki Kaisha
305120 Alberta Ltd.
TAR-Tankanlage Rumlang AG
TBN Tanklager-Betriebsgesellschaft Nurnberg mbH
Taglu Enterprises Ltd.
Taihei Bussan K.K.
Taiko Sekiyu K.K.
Taisei Kogyo Sekiyu Hanbai K.K.
Takahama Kosan Kabushiki Kaisha
Taketsuru Yugyo K.K.
Tanaka Sekiyu Hanbai K.K.
Tankanlage A. G., Mellingen
Tanklager Altishausen A. G.
Tanklager Gesellschaft, Koln
Tanklager-Gesellschaft Tegel
Tanklager Lechelles I S.A.
Tanklager Taegerschen AG
Tecnica Quimica Petrolera, S.A. de C. V.

Tecumseh Gas Storage Limited
THUMS Long Beach Company
Thyssengas G.m.b.H.
TIBA Speditions GmbH
Toa Nenryo Kogyo Kabushiki Kaisha
Tohko Plastics Company, Limited
Tohpren Co. Ltd.
Toko Sekiyu K.K.
Tonen Energy International Corp.
Tonen Maintenance K.K.
Tonen Sekiyukagaku Kabushiki Kaisha
Tonen Tanker Kabushiki Kaisha
Tonen Technology K. K.
Towa Compounding Co. Ltd.
Towa Sekiyu K.K.
Toyoshina Film Company, Ltd.
Trans-Arabian Pipe Line Company
Transalpine Oelleitung in Oesterreich Gesellschaft m.b.H.
Transgaz Lavera
Tsurumaru Unyu K.K.
Turkish Petroleum Company, Limited
UBAG—Unterflurbetankungsanlage Flughafen Zurich
Van Salt Water Disposal Company
W.A.G. Pipeline Proprietary Limited
Wako Jushi Kabushiki Kaisha
Wako Kasei Kabushiki Kaisha
Wartempomp Nederland B.V.
Westdeutsche Erdolleitungs-G.m.b.H.
Westgas G.m.b.H.
Westgastransport B.V.
Winnipeg Pipe Line Company Limited
Wohnungsbaugesellschaft, Steimbke-Rodewald G.m.b.H.
Worex et Cie
Yasaka Sekiyu K.K.
Yellowstone Pipe Line Company
Yoshiki Sekiyu Kabushiki Kaisha
Yoshimi Gas Kabushiki Kaisha
Yuai Sekiyu K.K.
Yugen Kaisha Nishi Kobe Bosai Center

MOBIL OIL CORPORATION

Abu Dhabi Petroleum Company Limited
Ace Polymer Co., Ltd.
Adria-Wien Pipeline Gesellschaft m.b.H.
AIMCO (ALPHA) Shipping Company
AIMCO Holdings Limited
AIMCO (OMEGA) Shipping Company Ltd.
Aircraft Fuel Supply B.V.
Airtankdienst Koln
AK Chemie GmbH
AK Chemie GmbH & Co KG
Akauma Asphalt Industries, Ltd.
Alexandroupolis Petroleum Installation S.A.
Allied Asphalts Limited
Alpa Alet Ve Dayanikli Tuketim Mamulleri Pazarlama A.S.
Alton Petrochemical Company Limited
Alyeska Pipeline Service Company
Ammenn GmbH
Ankara Gaz Satis Anonim Sirketi
Arabian American Oil Company
Arabian Energy Company Limited, The
Arabian International Maritime Company Limited
Arabian International Maritime Company
The Arabian Petroleum Supply Company (S.A.)
Arabian Shipping & Trading Company S.A.
Arabian Trading Company S.A.
Aral Aktiengesellschaft
A/S Fjellvegen
The Associated Octel Company Limited
Associated Octel Company (Plant) Limited
ATAS-Anadolu Tasfiyehanesi Anonim Sirketi
Atlas Sahara S.A.
Australian Synthetic Rubber Company Limited
Autobahn-Betriebe Gesellschaft m.b.H.
Aviation Fuel Services Limited
Aygaz Anonim Sirketi

B.V. Beheersmaatschappij MOBEM
Bayerische Erdgasleitung GmbH
Bin Sulaiman Mobil Towers
Bayerische Mineral Industrie A.G.
Beer GmbH
Beer GmbH & Co. Mineralol-Vertriebs—KG
Bow Fortune S.A.
Bow Spring Shipping S.A.
Bow Star S.A.
Bow Sun S.A.
Brussels Airfuels Service S.C.
Buffalo River Improvement Corporation
Canner's Steam Company, Incorporated
Canyon Reef Carriers, Inc.
CAS (Combined Automation Systems) B.V.
Celmisia Shipping Corporation
Central African Petroleum Refineries (Pvt) Limited
Central Kagaku Kabushiki Kaisha
Cercera S.A.
Changi Airport Fuel Hydrant Installation Pte. Ltd.
Chuo Nenryo Gas Kabushiki Kaisha
Colombianos Distribuidores de Combustibles, S.A. (CODI)
Colonial Pipeline Company
Comet-Bennstoffdienst GmbH
Commercial Polymers Pty. Ltd.
Commodore Maritime Company, S.A.
Compagnie Africaine de Transport Cameroun
Compagnie D'Entreposage Communautaire
Compagnie Rhenane de Raffnage
Compagnie Senegalaise des Lubrifiants (C.S.L.)
Compania de Lubricants de Chile Limitada (Copec-Mobil Ltda.)
Compania Mexicana de Especialidades Industriales, S.A. de C.V.
Consortium Raymond Duez
Cook Inlet Pipe Line Company
Cyprus Petroleum Refinery Limited
D. Muhlenbruch GmbH

D. Muhlenbruch GmbH & Co. KG
De. Ba. S.p.A.—Industrial Petrolifero Deposito di Bari
Depot Petrolier de Mourepiane
Depot Petrolier du Gresivaudan
Depot de Petrole Cotiers
Depots Petroliers de La Corse (DPLC)
Deutsche Pentosin-Werke GmbH
Deutsche Transalpine Oelleitung GmbH
Dicomi S.r.l.
Dixie Pipeline Company
Dukhan Services Company
East Japan Oil Development Company Ltd.
Eastern Lease Company Ltd.
East Texas Salt Water Disposal Company
Emoleum (Asphalts) Limited
Energas S.r.l.
Entrepot Petrolier de Chambery
Entrepot Petrolier de Dijon
Entrepot Petrolier de Mulhouse (E.P.M.)
Entrepot Petrolier de Nancy
Enterprise Jean Lefebvre
Erdgas-Verkaufs-Gesellschaft mbH
Erdoel-Lagergesellschaft mbH
Erdoel-Raffinerie Neustadt GmbH & Co. oHG
Erdoelbetrieb Reitbrook
Establissments Bouthenet
Ets. Starck & Cie
Europetrol S.p.A.
Faavang Autoverksted A/S
FACEL
Fairwind Maritime Company, S.A.
Felix Oil Company
Fibil, S.A.
Filtros De Costa Rica S.A.
Frome-Broken Hill Company Proprietary Limited
Fruehmesser Mineraloelhandels GmbH & Co. KG
Fruehmesser GmbH
Fuso Operations Kabushiki Kaisha

Futuro Enterprises (Christchurch) Ltd.
Futuro Homes (N.Z.) Ltd.
Gatwick Refueling Services Limited
Gaz Aletleri Anonim Sirketi
Geomines-Caen
Geovexin
Ghana Bunkering Services Limited
Goteborgs Branslesortering AB
Groupement Immobilier Petrolier G.I.P.
Groupement Petrolier Aviation G.P.A.
Groupement Petrolier De Brest (GPB)
Handelmaatschappij Hugenholtz & Co. B.V.
Haniel Handel Gmbh
H. van der Heijden Service Stations B.V.
Heizoel-Handelsgesellschaft mbH
Hellas Gas Storage Company S.A.
Hormoz Petroleum Company
Hydranten-Betriebs-Gesellschaft, Flughafen Frankfurt
Imbert G. Distribution De Produits Petroliers
Industrial Interamericana De Filtros Ltda. (INTERFIL)
Iranian Oil Participants Limited
Iranian Oil Services (Holdings) Limited
Iranian Oil Services Limited
Iraq Petroleum Company, Limited
Iraq Petroleum Pensions Limited
Iraq Petroleum Transport Company Limited
Iside, S.p.A.
Istanbul Petrol ve Makine Yaglari Limited Sirketi
Italoil S.p.A.
Japan Airport Fueling Service Co. Limited
J.E.C.O.P.
K.K. Sankyo Plastics
K.K. Toresen
Kansai Petro Terminal Co., Ltd.
Kanto Kygnus Sekiyu Hambai K.K.
Karl Storz Gmbh & Co. KG
Kawasaki Kygnus Sekiyu Hambai Kabushiki Kaisha
Keihin Kygnus Sekiyu Hambai Kabushiki Kaisha

Keiyo Sea-Berth Company, Limited
Kettleman North Dome Association
Klaus Koehn GmbH
Klaus Koehn GmbH & Co. Mineraloel KG
Kurt Ammenn GmbH & Co. K.G.
Kygnus Ekika Gas Kabushiki Kaisha
Kygnus Kosan Kabushiki Kaisha
Kygnus Marketing Service K.K.
Kygnus Sekiyu Kabushiki Kaisha
Kyokyto Petroleum Overseas, Ltd.
Kyokuto Sekiyu Kogyo Kabushiki Kaisha
Likit Petrol Gazi ve Yakit Ticaret A.S.
Lubland Limited
Lubricantes del Sur, S.A.
Marceaux & Cie
Matco Tankers (U.K.) Limited
Maury Manufacturing Company, Inc.
Milan Airport Refueling Service
Mediterranean Refining Company
Meentzen & Franke GmbH & Co.
Meritrans S.p.A.
Mertl GmbH
Mineralol-Handels-Gesellschaft Mbh
Mobil Atlas Sociedad Anonima de Capital Variable
Mobil Catalysts Corporation of Japan
Mobil Comercio, Industria e Servicos Ltda.
Mobil Corporation
Mobil Gaz-Mobil Petrol Gazlari Anonim Sirketi
Mobil Korea Lube Oil Industries Inc.
Mobil Motor Rest AG
Mobil Nile Oil Company
Mobil Oil Gabon
Mobil Oil Ghana Limited
Mobil Oil Maroc
Mobil Oil Nigeria Limited
Mobil Oil Nord-Africaine
Mosul Petroleum Company Limited
Motel Rest SA

Mt. Marrow Blue Metal Quarries Pty.
Near East Development Corporation
New Zealand Refining Company Limited, The
New Zealand Synthetic Fuels Corp. Ltd.
New Zealand Synthetic Fuels (Housing) Corporation Limited
Nichimo Oil (Bermuda) Co., Ltd.
Nichimo Sekiyu Seisei Kabushiki Kaisha
Nippon Unicar Company Limited
Norddeutsche Erdgas-Aufbereitungs GmbH
Nottingham Gas Limited
N.V. Rotterdam-Rijn Pijpleiding Maatschappij
N.V. Socony-Standard-Vacuum Oil Company
Octel Associates
Octel S.A.
Oilkol (Proprietary) Limited
Oil Service Company of Iran (Private Company)
Oldenburgische Erdoel Gesellschaft mit beschrankter Haftung
Olympic Pipe Line Company
P.T. Arun Natural Gas Liquefaction Company
P.T. Berau Coal
P.T. Stanvac Indonesia
Paloma Pipe Line Company
Pars Investment Corporation
Paul Harling Mineralole Gmbh & Co. KG
P.6—Groep B.V.
Peace Pipe Line Ltd.
Perretti Petroli S.p.A.
Petrocab
Petrogas Processing Ltd.
Petroleum Refineries (Australia) Proprietary Limited
Petroleum Services (Middle East) Limited
Petrol Fuel S.p.A.
Petrolrif S.p.A.
Petromin Lubricating Oil Company
Petromin Lubricating Oil Refining Company
Petromin-Mobil Yanbu Refinery Company Ltd.

Pipe Line Banal de La Goulette
Plegadizos para la Industria S.A.
Poly Oil Chimie (P.O.C.)
Progas Limited
Rainbow Pipe Line Company, Ltd.
Rhodes Petroleum Installation S.A.
Rivers Court Estates, Limited
Road Binders (Proprietary) Limited
Rohol-Aufsuchungs Gesellschaft mbH
Rundel Mineralolvertrieb GmbH
Ruhrgas Aktiengesellschaft
Samarco (Alpha) Shipping Company
Samarco (Beta) Shipping Company
Santa Clara Waste Water Company
Sarni S.p.A.
Saudi Arabian Maritime Company
Saudi Can Company, Ltd., The
Saudi Chemical Industries Company Limited
Saudi Maritime Company Ltd.
Saudi Tankers Limited
Saudi Yanbu Petrochemical Company
Schubert Kommanditgesellschaft
Segher de Mexico, S.A. de C.V.
Seibu Kygnus Sekiyu Hambai Kabushiki Kaisha
SENERCO
Seram Societa per Azioni (S.p.A.)
Sierra Leone Petroleum Refining Company Limited, The
Sociedad Calle 67, Ltda.
Societa Italiana per l'Oleodotto Transalpino, S.p.A.
Societe Africaine de Raffinage
Societe Alfred Ott & Cie
Societe Belge de Transport par Pipeline S.A.
Societe Camerounaise des Depots Petroliers (S.C.D.P.)
Societe Camerounaise Equatoriale De Fabrication De Lubrifiants "S.C.E.F.L."
Societe Civile de Mustapha
Societe Civile Immobiliere Courcelles-Etoile
Societe Civile Immobiliere de Construction de 34 Avenue du General Leclerc a Boissy-St-Leger

Societe Civile Immobiliere de Construction "La Residence Brune"
Societe Civile Immobiliere du 10 Bd. de la Republique A La Garenne-Colombes
Societe Civile Immobiliere Kleber-Etoile
Societe Civile Immobiliere La Fontaine Saint Lucien
Societe Dahomeenne d'Entreposage de Produits Petroliers
Societe d'Armement Fluvial et Maritime "SOFLUMAR"
Societe de Construction & de Gestion CB 12
Societe de Distribution Castelroussine (SODICA)
Societe de Gaz D'Oceanic (SOGADOC)
Societe de Gestion des Stocks Petroliers de Cote D'Ivorie
Societe de Manutention de Carburants Aviation (S.M.C.A.)
Societe de Manutention de Carburants Aviation Dakar-Yoff
Societe de Manutention de Carburants Aviation de Tahiti (SOMCAT)
Societe de Materialx d'Etancheite Pour Le Entreprises (Meple)
Societe d'Entreposage de Bobo-Dioulasso (S.E.B.)
Societe d'Entreposage de Gabes
Societe d'Entreposage d'Hydrocarbures de Bingo (SEHBI)
Societe d'Entreposage de San Pedro (SESP)
Societe d'Entreposage Petrolier au Burundi
Societe d'Habitations a Loyer Modere de la Seine Maritime
Societe des Bitumes et Cut-Backs du Cameroun
Societe Des Huiles Lemanhieu
Societe du Pipe-Line Sud-Europeen
Societe Francaise Stoner-Mudge
Societe Gabonaise d'Entreposage de Produits Petroliers
Societe Gabonaise de Raffinage
Societe Industrielle des Asphaltes et Petroles de Lattaquie (Syrie) S.A.
Societe Ivoirienne de Fabrication de Lubrifiants (S.I.F.A.L.)

Societe Ivoirienne de Raffinage
Societe Mauritanienne d'Entreposage de Produits
Petroliers
Societe Malienne D'Entreposage (SME)
Societe Nationale de Raffinage (Sonara)
Societe Nouvelle pour l'Epuration des Huiles de
Transformateurs—Septra
Societe Pizo De Formulation De Lubrifiants (PIZOLUB)
Societe Tahitienne de Depots Petroliers
Societe Tchadienne D'Entreposage de Produits Petroliers
Societe Togolaise d'Entreposage (STE)
Sonarep (South Africa) (Proprietary) Limited
SONEX
South African Oil Refinery (Proprietary) Limited
South Saskatchewan Pipe Line Company
Statfjord Transport A.S.
Sun East Company, Limited
Sydney Metropolitan Pipeline Pty. Ltd.
System Plaza Inc.
T.R. Miller Mill Company, Inc.
Tankbau Gmbh
Tanklagergesellschaft Koln-Bonn
Tecklenburg GmbH
Tecklenburg GmbH & Co. Energiebedarf K.G.
Thailand Lubricant Products Limited
Thailand Solvent Products, Ltd.
Thums Long Beach Company
T. M. Duche Co., Inc.
Toa Nenryo Kogyo Kabushiki Kaisha
Tohko Plastics Co., Ltd.
Tohpren Co., Ltd.
Tonen Energy International Corp.
Tonen Maintenance Kabushiki Kaisha
Tonen Properties, Inc.
Tonen Sekiyu Kagaku Kabushiki Kaisha
Tonen Tanker Kabushiki Kaisha
Tonen Technology Kabushiki Kaisha
Total Centrafricaine de Gestion (TOCAGES)

Towa Compounding Company Limited
Toyoshina Film Co., Ltd.
Tradewind Maritime Co., S.A.
Transalpine Finance Holdings S.A.
Transalpine Oelleitung in Oesterreich Gessellschaft
m.b.H.
Trans-Arabian Pipe Line Company
Turkish Petroleum Company Limited
Twifo Oil Palm Plantations Ltd.
UBAG Unterflur Betankungsanlage Flughafen Zurich
United Kingdom Oil Pipelines Limited
W.A.G. Pipeline Pty. Ltd.
Wako Kasei Kabushiki Kaisha
Wakohjushi Kabushiki Kaisha
Walton, Gatwick Pipeline Company Limited
Werner Weidemann Mineraloelvertrieb G.m.b.H.
West London Pipeline & Storage Limited
West Shore Pipe Line Company
Wilhelm Mertl GmbH & Co. KG
Wiri Oil Services Limited
Wolverine Pipe Line Company
WSG, Warmeservice Gmbh
Wyco Pipe Line Company
Wymondham Oil Storage Co., Limited
Zaire Mobil Oil
Zaire Services Des Entreprises Petrolieres

PHILLIPS PETROLEUM COMPANY

Alyeska Pipeline Service Company
Arctic LNG Transportation Company
Bissendorf Biosciences GmbH
Canada Western Cordage Company, Limited
Canyon Reef Carriers, Inc.
Chisholm Pipeline Company
Cochin Refineries Limited
Colonial Pipeline Company
Dixie Pipeline Company
East Texas Salt Water Disposal Company
Explorer Pipeline Company
Great Yarmouth Port Labour Company Limited
Heat Transfer Research, Inc.
Iranian Marine International Oil Company-Iminoco
Kenai LNG Corporation
Long Beach Oil Development Company
Multinational Gas and Petrochemical Services Limited
Norland GmbH fur Grundbesitz und Industrieanlagen
Norpipe A.S.
Norpipe Petroleum UK Limited
Norsea Gas A/S
Norsea Gas GmbH
Norsea Pipeline Limited
Oil Insurance Limited (New)
Papago Chemicals, Inc.
Phillips Carbon Black Limited
Phillips Petroleum International Andina, S.A.
Phillips Petroleum Singapore Chemicals (Private) Limited
Phillips Petroleum Toray Inc.
Phillips-Imperial Petroleum Limited
Polar LNG Shipping Corporation
Renolit—Haus GmbH
Solar Gas, Inc.
Spodco Limited

Spodco-USA, Inc.
The Salk Institute Biotechnology/Industrial Associates Inc.
Venezoil, C.A.
Western Desert Operating Petroleum Company (WEPCO)
White River Shale Oil Corporation

SHELL OIL COMPANY*

A. *Shell Oil Company*

Subsidiary Companies

IND/AG Chemicals, Inc.
Pecten Arabian Company
Pecten Cameroon LNG Limited
Pecten Chemicals Inc.
Pecten Export Corporation
Pecten Middle East Services Company
Pecten Trading Company
Pecten Ventures Limited
Pecten Vietnam Company
SES, Incorporated
Shell Agricultural Chemical Company
Shell Capital, Inc.
Shell Communications, Inc.
Scallop Corporation
Shell Credit, Inc.
Shell Energy Resources Inc.
Shell Export Company
Shell Investment, Inc.
Shell Motorist Club, Inc.
Shell Pipe Line Corporation
Shell Polymers and Catalysts Enterprises Inc.

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* Shell Oil Company's parent corporation is SPNV Holdings, Inc., which, in turn, is owned by Shell Petroleum N.V. The latter's parents are Royal Dutch Petroleum Company (a Netherlands corporation) and The "Shell" Transport and Trading Company, p.l.c. (a United Kingdom corporation). Shell Oil Company itself owns directly or indirectly, both 100% and less than 100% stock interests in approximately 120 corporations that operate both in the United States and in foreign countries. All of the companies are often referred to collectively as the "Royal Dutch/Shell Group of Companies." Counsel is advised that there are subsidiaries, not wholly owned, and affiliates throughout the world of this group which, in the aggregate, are so numerous that they could not be determined or identified for the Court within the time frame for filing this Jurisdictional Statement.

Triton Biosciences Inc.
Western Farm Services, Inc.

Affiliated Companies

Fractionation Research, Inc.
Gravcap, Inc.
Heat Transfer Research, Inc.
Inland Corporation
Loop, Inc.
Lucky Chance Mining Company, Inc.
Mesbic Financial Corporation of Houston
Oil Companies Institute for Marine Pollution Compensation Limited
Oil Insurance Limited
Seadock, Inc.

B. *Shell Credit, Inc.*

Subsidiary Companies

Shell Finance Company
Shell Leasing Company

C. *Shell Energy Resources Inc.*

Subsidiary Companies

Pecten International Company
Shell Gas Piepline Company
Shell Gas Trading Company
Shell Mining Company
Shell Offshore Inc.
Shell Western E&P Inc.
Scallop Coal Company

D. *Pecten International Company*

Subsidiary Companies

Pecten Argentina Company
Pecten Ash Sham Company

Pecten Bahamas Company
Pecten Belize Company
Pecten Brazil Alagoas Company
Pecten Brazil Alagoas Petroleum Company
Pecten Brazil Amazon Company
Pecten Brazil Amazon Exploration Company
Pecten Brazil Amazon Exploration and Development Company
Pecten Brazil Amazon Petroleum Company
Pecten Brazil Bahia Company
Pecten Brazil Bahia Exploration Company
Pecten Brazil Bahia Exploration and Development Company
Pecten Brazil Bahia Petroleum Company
Pecten Brazil Exploration Company
Pecten Brazil Maranhao Company
Pecten Brazil Maranhao Exploration Company
Pecten Brazil Petroleum Company
Pecten Brazil Rio Grande Do Norte Company
Pecten Cameroon Company
Pecten Canada Limited
Pecten Ecuador Company
Pecten Guinea-Bissau Company
Pecten Malaysia Company
Pecten Malaysia Petroleum Company
Pecten Orient Company
Pecten Overseas Petroleum Company
Pecten Paraguay Company
Pecten Portugal Company S.A.R.L.
Pecten Potiguar Company
Pecten Santos Company
Pecten Santos Exploration Company
Pecten Santos Petroleum Company
Pecten Sarawak Company
Pecten Syria Company
Pecten Syria Petroleum Company
Pecten Tanzania Company
Pecten Tunisia Company

Pecten Victoria Company
Taranaki Offshore Petroleum Company

E. *Shell Mining Company*

Subsidiary Companies

Bellaire Trucking Company
Pecten Coal International Inc.
R. & F. Coal Company
Triton Coal Company
Turris Coal Company
Billiton Metals Inc.
Billiton Minerals U.S.A. Inc.

F. *Shell Offshore Inc.*

Subsidiary Companies

Burrwood Gathering Company
SOI Royalties Inc.

G. *Shell Western E&P Inc.*

Subsidiary Companies

Belridge Farms
Belridge Packing Co.
Chaparro Gathering Company
Choctaw Pipe Line Company
Swepi Royalties Inc.
Shell California Offshore Pipeline Inc.
Shell Cortez Pipeline Company
Shell Western Pipelines Inc.
East Texas Salt Water Disposal Company
Grande Ecallie Land Company, Inc.
Thums Long Beach Company
Van Salt Water Disposal Company
WIDC (Wyoming Industrial Development Corporation)

H. *Shell Cortez Pipeline Company*

Affiliated Company

Cortez Capital Corporation

I. *Pecten Arabian Company*

Subsidiary Company

Pico Limited

J. *Taranaki Offshore Petroleum Company*

Subsidiary Company

Taranaki Offshore Petroleum Company Limited

K. *Shell Chemical Company*
(a division of Shell Oil Company)

Affiliated Companies

George Newman & Company
United Scientific, Inc.

L. *Pecten Trading Company*

Affiliated Company

Oil Companies Institute for Marine Pollution Compensation Limited

M. *Western Farm Service, Inc.*

Subsidiary Company

Pioneer Equipment Co.

N. *Shell Pipe Line Corporation*

Subsidiary Companies

Butte Pipe Line Company
San Joaquin Valley Pipe Line Company

Affiliated Companies

Dixie Pipeline Company
Explorer Pipeline Company
Locap, Inc.
Olympic Pipe Line Company
Plantation Pipe Line Company
West Shore Pipe Line Company
Wolverine Pipe Line Company

O. *Shell Polymers and Catalysts Enterprises Inc.*

Subsidiary Companies

Ardyne Inc.
CRI Ventures, Inc.
Morrison Molded Fiber Glass Company
Premix/EMS Inc.
Quazite Corporation
Rampart Packaging Inc.
Xerkon Inc.

P. *Morrison Molded Fiber Glass Company*

Subsidiary Companies

AFC, Inc.
Glastrusions, Inc.
Glass-Steel, Inc.

Q. *Scallop Coal Company*

Subsidiary Companies

Justin Coal Corporation
Marrowbone Development Company
Wolf Creek Collieries Company
Massey Coal Terminal Corporation

R. *Billiton Metals Inc.*

Subsidiary Companies

Billiton Commodies Inc.

S. *Scallop Corporation*

Subsidiary Compa

AP Shipping Corporation
Argus Realty Services Inc.
Asiatic Petroleum Corporation
Greater New York Terminal, Inc.
Houston Fuel Oil Terminal, Inc.
Nickerson American Plant Breeders Inc.
Royal Lubricants Company, Inc.
Scallop Liquified Natural Gas, Inc.

T. *Marrowbone Development Company*

Subsidiary Companies

Big Beaver Coal Company

U. *Massey Coal Terminal Corporation*

Subsidiary Companies

Clipper Coal Corporation
Comcoal Corporation
East Kentucky Energy Corporation
Kermit Coal Company
Pike County Coal Corporation
Redbone Coal Company, Inc.
Massey Coal Terminal S. C. Corporation
SLT Corporation
Sunset Coal Corporation
Tug River Mining Group, Inc.

V. *Massey Coal Terminal S. C. Corporation*

Subsidiary Companies

Cooper River Coal Terminal Company

UNION OIL COMPANY OF CALIFORNIA

Unocal Corporation
Union Exploration Partners, Ltd.

5

No. 87-453

In The

Supreme Court of the United States

October Term, 1987

AMERADA HESS CORPORATION, *et al.*,

Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

MOTION OF APPELLEE TO DISMISS OR AFFIRM

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QUESTION PRESENTED

Whether the Due Process, Commerce or Equal Protection Clause of the United States Constitution prevents New Jersey from denying a deduction under its corporate franchise tax for the federal crude oil windfall profit tax.

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No. 87-453

In The

Supreme Court of the United States

October Term, 1987

AMERADA HESS CORPORATION, *et al.*,

Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

MOTION OF APPELLEE TO DISMISS OR AFFIRM

Appellee Director, Division of Taxation respectfully moves pursuant to Rule 16(1)(b) and (d) to dismiss this appeal or to affirm the judgment of the Supreme Court of New Jersey because the issue presented does not raise a substantial federal question and because the decision below was manifestly correct.

COUNTERSTATEMENT

The 11 oil company appellants would have this Court set down for full briefing and argument their appeal from

a decision of the Supreme Court of New Jersey which, after holding as a matter of New Jersey law that appellants could not deduct the federal crude oil windfall profit tax ("WPT") in computing their New Jersey corporation business tax liabilities, concluded that denying the deduction violated no provision of the United States Constitution (App33a to App35a).[1] In rejecting appellants' Due Process Clause claim, the New Jersey Supreme Court reasoned that since the oil companies "are concededly unitary businesses," (App33a), New Jersey is entitled to include in the income measure of the corporation business tax 100% of each company's entire net income reduced by the standard three-factor apportionment formula to reflect each company's business activity in New Jersey (*ibid.*). Having determined as a matter of New Jersey law that the issue confronting the court was whether appellants are entitled to a deduction for the WPT, not whether a segment of their oil production income having an out-of-state source should be added to the base, the New Jersey court found no infringement of the territorial constraints of the Due Process Clause. The New Jersey Supreme Court held that there was no violation of either the Commerce Clause or Equal Protection Clause because denying a deduction for the WPT "does not favor in-state over out-of-state economic activity" (App34a), does not favor in-state over out-of-state companies or transactions, and indeed draws no distinction "based on the interstate nature of plaintiffs' businesses . . ." (*ibid.*). Reaching the companies' argument that they are discriminated against vis-a-vis non-oil

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[1] "App." refers to the appendix to the jurisdictional statement.

producing petroleum marketers, the New Jersey court reasoned that these marketers do not pay the WPT and have not benefitted from the lifting of crude oil price controls as have the producer marketers. Hence the statute draws no invidious or irrational distinctions. The New Jersey court rejected appellants' Supremacy Clause argument (not pressed here) on the ground that there was no indication that accomplishment of federal energy or revenue policies would be thwarted by New Jersey's denial of a deduction for the WPT (App34a to App35a).

The New Jersey Corporation Business Tax Act (*N.J.S.A.* 54:10A-1 et seq.), which was construed by the Supreme Court of New Jersey to deny a deduction for the WPT, is a franchise tax, measured in the years before the Court (1980 and 1981) by the sum of a tax based on net income and a tax based on net worth.[2] *See Werner Machine Co. v. Director, Division of Taxation*, 350 *U.S.* 492 (1956). The income measure of the CBT is based on a corporation's taxable income for federal income tax purposes prior to net operating losses and special deductions (*e.g.* the dividends received deduction allowed by *IRC* § 243(a)), but this preliminary computation is modified to deny certain deductions allowed for federal income tax purposes. Among such disallowed deductions are "[t]axes paid or accrued to the United States on or measured by profits or income . . . " *N.J.S.A.* 54:10A-4(k)(2)(C) (A. App2a).[3] As construed by the Supreme Court of New Jer-

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[2] The net worth measurement of the tax no longer exists as of taxable years beginning on or after July 1, 1986. *N.J.S.A.* 54:10A-5(a).

[3] "A. App." refers to the appendix to this motion to dismiss or affirm.

sey, this provision denies a deduction for the WPT, and it is this provision that, according to appellants, violates their constitutional rights.

The Crude Oil Windfall Profit Tax Act of 1980, *P.L.* 96-223, 94 *Stat.* 229, 26 *U.S.C.* § 4986 *et seq.* (*IRC* § 4986 *et seq.*) was enacted as part of the Carter Administration's program to decontrol the price of crude oil. The tax was perceived by the Administration and its drafters as a tax on the unearned wellhead profits of oil producers resulting purely from increases in the controlled price of crude oil (which ranged at that time from approximately $6 to $13 per barrel) to the uncontrolled price (which was then approximately $20 per barrel). *H.R. Rep.* No. 304, 96th Cong., 1st Sess. 5, 6 (1979). As stated by the President:

> I want to emphasize that this Windfall Profits Tax is not a tax on the American people. It is purely and simply a tax on the new profits of the oil producers which they will receive but not earn [15 Weekly Comp., Pres. Docs. 611 (April 5, 1979)].

In the words of the Congressional Budget Office, the principal purpose of the tax was to "capture a larger portion of the additional producer revenues than would be taxed through the existing corporate income tax" and to reach the "unanticipated profits arising from decontrol or increases in world prices." Cong. Budget Office, "The Windfall Profits Tax: A Comparative Analysis of Two Bills," 1 (Nov. 1979).

Since the purpose of the tax is to capture increased profits attributable to the decontrol of crude oil prices, the tax is imposed on wellhead profit or income rather than on the ultimate sale of refined crude oil and petro-

chemical products. Accordingly, the basic measurement of the tax is the difference between the uncontrolled price ("removal price") and the controlled price ("adjusted base price") of a barrel of crude oil when the oil is removed from a producing property. *IRC* § 4988(a); *IRC* § 4989. In the case of integrated oil companies such as the appellants, removal of oil from a producing property may not correspond with a sale or exchange of the oil to a third party, in which case the constructive sales price (generally the posted price of oil in the particular field) is substituted for the sales price in determining the uncontrolled or removal price of the oil. *IRC* § 4988(c)(3); *Treas. Reg.* § 1.613-3(a). This difference between the controlled and uncontrolled price is the windfall profit (*IRC* § 4988(a)) on which the tax is imposed. *IRC* § 4986(a).

To ensure that the WPT is not imposed when there is no profit, *i.e.*, when the cost of producing oil exceeds its price, Congress enacted an alternative base for the tax—the net income limitation. *IRC* § 4988(b); *H.R. Rep.* No. 304, 96th Cong., 1st Sess., 2 (1979); *S.Rep.* No. 394, 96th Cong., 2nd Sess., 29 (1979). Under *IRC* § 4988(b)(1) the windfall profit cannot exceed 90% of the net income per barrel. In determining its net income for purposes of the limitation, a producer is entitled to deduct all its expenses incurred in producing the oil. *IRC* § 4988(b)(3)(A); *Treas. Reg.* § 1.613-5(a).[4] As a result of the net income

[4] Certain preferential deductions allowed for federal income tax purposes under certain circumstances, including percentage depletion and intangible drilling costs, are not allowed in determining taxable income for purposes of the net income limitation. *IRC* § 4988(b)(3)(B). Cost depletion, however, is allowed, and amounts which would otherwise be deducted as intangible drilling costs are included in the depletable cost base and allowed over time in the form of cost depletion. *IRC* § 4988(b)(3)(C)(i)(1).

limitation, the windfall profit is always net of a producer's cost to produce a barrel of oil. In fact, in many instances the WPT allows for the deduction of more than actual costs because in every case where the controlled price exceeds actual costs, a producer deducts the higher amount in the form of the adjusted base price. *IRC* § 4988(a) and *IRC* § 4988(b). To paraphrase *N.J.S.A.* 54:10A-4(k)(2)(C), the windfall profit tax is a tax paid or accrued to the United States on or measured by the windfall profit or the net income per barrel.

The WPT is not a severance tax because its base is not the market value of oil at the wellhead nor the quantity of production. *See IRC* § 4996(c)(2) defining the term "severance tax" for purposes of the WPT and *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 *U.S.* 207, 228, n. 12 (1980). The base of the WPT allows a deduction from the market value of the oil for the greater of the adjusted base price or a producer's actual costs. As stated by the New Jersey Supreme Court, "The windfall profit cannot be equated with the market value of oil; it is a net amount, not simply the sales price, as in the case of federal transactional excise taxes" (App17a).

The WPT is a temporary tax. It is to be phased out over a 33-month period beginning no later than December 1990. *IRC* § 4990(c).

Certain false impressions produced by the jurisdictional statement should be briefly noted. First, the Supreme Court of New Jersey's construction of the CBT does not "preclude . . . a deduction for the billions of dollars in WPT payments that appellants and others have

made to the federal government since 1980" (J.S. 3).[5] Rather, by reason of the application of the three-factor apportionment formula, only a small fraction of each company's WPT payments is disallowed. Second, whether WPT payments are correctly treated as inventoriable production costs and thus part of cost of goods sold for federal income tax purposes (*cf.* J.S 6) is unclear, (*see* Joint brief for defendant-respondent Director, Division of Taxation, Superior Court of New Jersey, Appellate Division, Docket No. A-2795-84 T7 *et seq.* at 55 to 57), but what is clear is that certain of these appellants in fact treated the WPT as a tax expense, not an inventoriable production cost. (Appellate Division joint appendix for plaintiffs-appellants 1289a, 1305a, 1307a). Thus, the WPT was not an item of cost of goods sold for at least some of the appellants. Third, to the extent that Congress may have assumed that the WPT would in general be deductible for State tax purposes (J.S. 7), that assumption appears only in the House and Senate reports (*ibid.*) and only in connection with estimating the revenue effect of the tax. As shown by the fact that the WPT will begin to phase out no later than January 1991 whether or not net windfall revenues reach $227.3 billion (*IRC* § 4990(c); *IRC* § 4990(d)), the revenue estimate was not an essential element of the legislation. Moreover, there was no connection whatever in Congress' mind between the deductibility of the WPT for state tax purposes and the accomplishment of federal energy policies. The WPT may have been crafted so as not to create undue production disincentives, but this tailoring of the Act did not include an assumption that the

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[5] "J.S." refers to the jurisdictional statement.

WPT would be deductible for state tax purposes. As stated in the Senate Report:

> [The Committee] believes that any such tax should be structured carefully to eliminate as much as possible, adverse effects on domestic production. For this reason the committee substitute contains several exemptions from the tax for types of oil whose production it believes to be especially responsive to more lenient tax treatment, such as newly discovered oil, tertiary oil, stripper oil and heavy oil.[6] [*S. Rep.* No. 96-394, 96th Cong., 2nd Sess. 6 (1979)].

Appellants persist throughout the jurisdictional statement in labeling *N.J.S.A.* 54:10A-4(k)(2)(C) an "add-back" provision. The New Jersey Supreme Court, however, flatly rejected this characterization, concluding as a matter of state law that the provision at issue denies a deduction in determining entire net income (App12a). Appellants are precluded in this Court from rearguing the state law question decided against them by the Supreme Court of New Jersey.

Attempting to lay the foundation for an argument that this case presents a substantial question, appellants advise that, "Many State tax schemes employ comparable add-back provisions" (J.S. 8). With the exception of the New York franchise tax, however, there are few, if any, state taxes which employ language identical to New Jersey's CBT. *See* App85a to App91a). Whether the differing language in these other statutes could be construed

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6 *See e.g., IRC* § 4987(b), *IRC* § 4991(d) and *IRC* § 4991(e), imposing lower tax rates on newly discovered, tertiary, stripper, and heavy oil.

to deny a deduction for the WPT is an open question. Finally, appellants' statement (J.S. 11) that the New Jersey Supreme Court failed to address their argument that they are discriminated against vis-a-vis independent marketers is simply untrue. The court responded to this argument in rejecting appellants' claim under the Equal Protection Clause (App34a), and appellants themselves argued in the courts below that "cases striking down State taxes because of their discriminatory impact on interstate commerce also rely upon the Equal Protection Clause . . ." (Joint brief on behalf of plaintiffs-appellants, Superior Court of New Jersey, Appellate Division, Docket No. A-2795-84T7 *et seq.* at 72).

ARGUMENT

POINT I

PLENARY REVIEW IS NOT WARRANTED BECAUSE THE QUESTION IS NOT SUBSTANTIAL.

The issue of whether New Jersey can constitutionally deny a deduction for the WPT under its corporate franchise tax is not substantial. The New Jersey statutory language—"taxes paid or accrued to the United States on or measured by profits or income . . ." (*N.J.S.A.* 54:10A-4(k)(2)(C)) is unobjectionable on its face and when applied to most federal taxes. Even if appellants were correct that the statute is unconstitutional when applied to them, a decision by this Court to that effect would do no more than prohibit the application of the statutory

provision to a particular set of facts, *i.e.*, where the federal tax is referenced to an out-of-state activity. Similar disallowance provisions in other state corporation taxes, as well as *N.J.S.A.* 54:10A-4(k)(2)(C) itself, would continue in force. A later case seeking the Court's review of a similar disallowance provision would involve a different set of facts, such that a decision in this case would not necessarily control the outcome. Any principle announced in this case, were the Court to accept it for plenary review, would establish nothing more than the invalidity of *N.J. S.A.* 54:10A-4(k)(2)(C) when applied to a unique set of facts.

Moreover, the decision of the Supreme Court of New Jersey denying a deduction for the WPT does not have national ramifications, either from the perspective of the revenue involved or the decision's effect on other States. While crude oil producers may have paid more than $78 billion in WPT to the federal government (J.S. 13), the amounts paid by these appellants to New Jersey are small by comparison since in every case the three-factor apportionment formula greatly reduces each appellant's entire net income taxable in New Jersey. *See* App84a showing total WPT payments by these appellants for the years at issue in this litigation of approximately $20.5 million.[7] Additionally, following the worldwide drop in crude oil prices, beginning in 1982, New Jersey's CBT receipts attributable to denying a deduction for the WPT have steadily decreased.[8] On the national scene, according to appellants, only six States in addition to New Jersey presently disallow the deduction (J.S. 14). Of these six, only Minnesota and Wisconsin expressly deny a deduction for the tax, while, with the exception of New York, every other State's generic denial of a deduction for certain federal taxes is phrased differently from New Jersey's. Whether these differently worded disallowance provisions could be construed to apply to the WPT under the New Jersey Supreme Court's opinion is unclear. The likelihood of other States' amending their corporation taxes to specifically deny a deduction for the WPT is slight. Potential state revenue to be gained from denying the deduction has decreased due to the worldwide drop in crude oil prices, and the potential revenue source is of temporary duration because the WPT will begin to phase out no later than January 1991. In light of the temporary nature of the WPT, the decline in revenues which can be anticipated from denying a deduction for the tax, and the dissimilarity in other States' statutory language, it is unlikely that the opinion of the Supreme Court of New Jersey will encourage other

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7 Even with the addition of $78 million attributable to denying a deduction for the WPT through 1984 (J.S. 14), New Jersey's revenue gains are minute by comparison to total WPT paid to the federal government.

8 The records of the New Jersey Division of Taxation show the following approximate revenues attributable to denying a deduction for the WPT to these and other producers of crude oil through the 1984 taxable year:

1980	$ 10.7 million
1981	36.7 "
1982	19.8 "
1983	12.9 "
1984	8.4 "
Total	$ 88.5 million

(The figures do not include deficiency interest.)

States to enact similar disallowances or to interpret their corporation taxes in a similar fashion.

In addition to the fact that an opinion by this Court after plenary review would not establish a significant principle of constitutional law nor have nationwide importance, appellants' claim of geographic distortion (J.S. 11 to J.S. 13) has been dealt with already, albeit in a slightly different form, in *Exxon Corp. v. Wisconsin Dept. of Revenue, supra.*

The Court has repeatedly stated that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Co. v. Minnesota*, 358 *U.S.* 450, 460 (1959); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 *U.S.* 425, 436 (1980); *Exxon Corp. v. Wisconsin Dept. of Revenue, supra,* at 219. Both the Due Process Clause of the Fourteenth Amendment and the comparable requirements of the Commerce Clause are satisfied if there is a sufficient connection between "the interstate activities and the taxing State, and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Mobil Oil Corp. v. Commissioner of Taxes, supra* at 436-37; *Exxon Corp. v. Wisconsin Dept. of Revenue, supra* at 219-20. If a business is found to be unitary, the taxing State has a sufficient connection with a multistate corporation's activities to tax its entire net income even though a portion of that income may have its geographic source outside the State. *Exxon Corp. v. Wisconsin Dept. of Revenue, supra* at 220-21, 223. As the Supreme Court of New Jersey

pointed out, appellants "are concededly unitary businesses" (App33a). Appellants concededly do business in New Jersey (J.S. 3). Accordingly, there is a sufficient connection between New Jersey and appellants' interstate activities to permit New Jersey to subject appellants' entire net income to tax without violating the nexus requirement of either the Due Process or Commerce Clause.

In only one case involving a unitary business has the Court found that the *quantum* of income subjected to a state tax violated the further requirement of the Due Process Clause that there be a rational relationship between the income attributed to the State and the intrastate values of the enterprise. In *Hans Rees' Sons v. North Carolina, ex rel. Maxwell*, 283 *U.S.* 123 (1931), the Court concluded that the taxpayer had established by clear and cogent evidence that formula apportionment resulted in a tax on approximately 80% of the corporation's income while only 17% of the income had its actual source in the taxing State. In other cases, taxpayer claims that formulary apportionment violates the Constitution by subjecting too much of their income to tax have met with no success. *See Underwood Typewriter Co. v. Chamberlain*, 254 *U.S.* 113 (1920); *Moorman Mfg. Co. v. Bair*, 437 *U.S.* 267 (1978). While obviously dealing with state tax apportionment formulas and not the computation of net income, these apportionment cases nevertheless demonstrate that, once beyond the nexus requirement of the Due Process and Commerce Clauses, taxpayers must conclusively demonstrate the most severe distortion of income in order to obtain relief from a state taxing scheme. Short of this, the requirement of the Due Process and Commerce Clauses

that there be a rational relationship between the amount of income taxed and the in-state activities of the business is satisfied.

Appellants do not even attempt to establish that New Jersey's denial of a deduction for the WPT results in an irrational, arbitrary *amount* of their income being subjected to tax. Instead, they suggest that the mere fact that the production of crude oil takes place outside New Jersey, combined with New Jersey's disallowance of a deduction for a cost associated with that production, results in a "material geographic bias" (J.S. 12) in the net income base. There is no such bias. The tax base of the New Jersey corporation business tax is entire net income with certain adjustments. *N.J.S.A.* 54:10A-5(c); *N.J.S.A.* 54:10A-4(k). Entire net income (prior to the statutory adjustments) is deemed to be federal taxable income prior to the net operating loss deduction and special deductions. *N.J.S.A.* 54:10A-4(k). Federal taxable income, in turn, derives from appellants' gross receipts and other income, realized throughout their integrated petroleum businesses. *See* App33a. New Jersey's denial of a deduction for a cost which happens to have a geographic source outside the States does not distort the base to any greater degree than does inclusion of income from a non New Jersey source. Since appellants are unitary businesses, neither the inclusion of their oil production income as sanctioned in *Exxon Corp. v. Wisconsin Dept. of Revenue, supra,* nor the denial of a deduction attributable to oil production interjects an unconstitutional geographic bias into the net income base. Unless appellants can establish that something other than income from their integrated petroleum enterprises is being taxed,

New Jersey's denial of a deduction for the WPT introduces no unconstitutional distortion to the net income base of the CBT.

Aside from the fact that it has no legitimate constitutional source, appellants' theory of geographic distortion, if accepted, would be unworkable. Every deduction a State chose to disallow in determining the net income of a unitary business would have to be scrutinized to determine whether the disallowed cost related to an out-of-state activity. For instance, under the New Jersey CBT, another of the federal income tax deductions disallowed in computing entire net income is a portion of interest paid to 10% or more shareholders. *N.J.S.A.* 54:10A-4(k)(2)(E) (*see* A. App2a). Under appellants' theory, this provision could not be applied where both the debt and the 10% or more shareholder were located outside New Jersey. Under appellants' theory, while New Jersey would be precluded from denying a deduction for the WPT, New York, which has a virtually identical disallowance provision in its franchise tax (*see* App88a), could constitutionally deny the deduction because the State has minimal crude oil production within its borders (J.S. 15, n.12). Finally, no State could deny a deduction for real property taxes, despite state fiscal exigencies, unless the property were located in-state. The Constitution surely is not meant to restrict in this fashion the States' ability to raise revenue to support their sovereign governments. The one exception would be a disallowance provision aimed at nonresidents *qua* nonresidents, such as the provision at issue in *Travis v. Yale & Towne Mfg. Co.*, 252 *U.S.* 60, 79 (1920), which denied personal exemptions under a state personal income tax to nonresidents while allowing them

to residents. The New York franchise tax provision at issue in *Westinghouse Electric Corp. v. Tully*, 466 *U.S.* 388 (1984), was similar in nature, allowing a tax credit which increased in direct proportion to a taxpayer's shipments from New York ports. Here, to the contrary, New Jersey is neither disadvantaging nonresidents as such nor providing tax benefits for economic activity within the State. Accordingly, appellants' arguments to the contrary notwithstanding (J.S. 17), there is no suspicious tailoring of the CBT to the disadvantage of nonresidents or out-of-state economic activity.

In sum, appellants' geographic distortion argument is nothing more than a remodel of Exxon's argument in *Exxon Corp. v. Wisconsin Dept. of Revenue, supra,* and appellants' attempt to inflate the issue to one of national importance is transparent. As the Tax Court of New Jersey remarked three years ago, "This is a case of statutory construction" (App43a). The federal question is not substantial.

POINT II

PLENARY REVIEW IS NOT WARRANTED BECAUSE THE SUPREME COURT OF NEW JERSEY CORRECTLY REJECTED APPELLANTS' CLAIMS THAT DENIAL OF A DEDUCTION FOR THE WINDFALL PROFIT TAX IMPOSES NEW JERSEY'S CORPORATION BUSINESS TAX ON EXTRATERRITORIAL VALUES AND DISCRIMINATES AGAINST INTERSTATE COMMERCE.

Denial of a deduction for the WPT does not result in the corporation business tax being unfairly apportioned. The crux of appellants' argument, as made clear at p.20

of their jurisdictional statement, is that by denying a deduction for the WPT, New Jersey is taxing too much of their income. As demonstrated above in Point I, however, taxpayers claiming that a state tax bears too heavily on a unitary business have an extremely difficult burden of proof. The fundamental concept underlying the unitary business principle is that it is impossible to separately account for the profitability of each segment of such a business.

> [S]eparate accounting, while is purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. [*Mobil Oil Corp. v. Commissioner of Taxes, supra* at 438].

Appellants, which are concededly unitary businesses, have not demonstrated or even attempted to demonstrate what portion of their income should properly be attributed to New Jersey. They thus have not demonstrated that denying a deduction for the WPT attributes too much of their net income to the State. *See Container Corp. v. Franchise Tax Board*, 463 *U.S.* 159, 182 (1983).

Appellants suggest that denial of a deduction for a cost associated with an out-of-state activity is the equivalent of doubling the income from an out-of-state activity (J.S. 19). Appellants overlook the fact that the CBT is based upon federal taxable income, which in turn is derived from each of these appellants' realized gross receipts. Denying a deduction for the WPT may increase the amount of each appellant's taxable income, but it is not equivalent to adding gross receipts to the tax base. A simple example illustrates the difference. Assume that

one of the appellants had gross receipts of $100, deductions including the WPT of $91, and deductions not including the WPT of $90. The appellants' and New Jersey's positions are shown schematically as follows:

	Appellants	*New Jersey*
Gross receipts	$100	$100
Deductions including WPT	$ 91	
Deductions not including WPT		$ 90
Entire net income	$ 9	$ 10

Denying a deduction for the WPT does not add an item of gross receipts to the tax base, which remain $100 in both cases. The Supreme Court of New Jersey rejected appellants' argument that denying a deduction for the WPT is equivalent to including an additional item of income (App33a).

Appellants' next argument that denial of a deduction for the WPT is tantamount to New Jersey's imposing its own WPT (J.S. 20 to J.S. 24) is frivolous. The argument rests on the premise that *N.J.S.A.* 54:10A-4(k)(2)(C) adds an item of gross receipts to the CBT base and imposes a tax on the "add-back." Appellants again overlook the fact that the Supreme Court of New Jersey construed the provision as one disallowing a deduction (App12a). As a matter of state law, appellants are thus foreclosed from arguing in this Court that *N.J.S.A.* 54:10A-4(k)(2)(C) is an "add-back" provision. Moreover, as made clear by the example in the preceding paragraph, denying a deduction for the WPT is not the tax equivalent of New Jersey's imposing its own WPT. The tax base of the CBT is realized gross receipts less certain deductions. Whether the WPT is allowed or disallowed affects the amount of net

income to be included in the base, but the base remains appellants' gross receipts from the sale of petroleum products less certain deductions. In taxing more or less of appellants' net income, New Jersey is not reaching out to tax values outside its borders in the form of imposing its own WPT. Rather, it is taxing an apportioned share of these appellants' unitary net business income. Since appellants are unitary businesses, New Jersey is entitled to tax such apportioned share even though a portion of the income has its geographic source in other States.

If appellants were correct that denying a deduction was tantamount to taxing the disallowed item, the theory would create extraordinary tax anomalies. The other adjustments in *N.J.S.A.* 54:10A-4(k)(2) include the disallowance of a deduction for 90% of interest paid on debt to 10% or more shareholders (*N.J.S.A.* 54:10A-4(k)(2)(E)) and the disallowance of a deduction for the excess of federal accelerated cost recovery system depreciation over depreciation computed according to pre-1981 federal income tax methods. *N.J.S.A.* 54:10A-4(k)(2)(F)(i). (A. App3a). If the appellants were correct in their theory, the disallowance of these deductions would mean that the CBT is imposed upon interest paid out and depreciation claimed. Under appellants' theory the federal income tax disallowance of a deduction for capital expenditures (*IRC* § 263) would mean that the federal government is taxing capital.

In short, denial of a deduction for the WPT does not unconstitutionally tax extraterritorial values. Rather, the effect of the disallowance is simply to augment appellants' entire net income, all of which is subject to the CBT because appellants are unitary businesses.

Appellants' final argument (J.S. 24 to J.S. 30) is that denying them a deduction for the WPT discriminates against interstate commerce because the denial has the effect of imposing a greater tax liability on account of their out-of-state activities, namely the production of crude oil. Plaintiffs' argument is doomed to fail under ***Exxon Corp. v. Governor of Maryland***, 437 *U.S.* 117 (1978).

The Commerce Clause prohibits a State from taxing transactions involving interstate commerce more heavily than transactions not involving such commerce (***Boston Stock Exchange v. State Tax Commission***, 429 *U.S.* 318 (1977)), from drawing distinctions between interstate transactions in ways which favor local commercial interests (***Westinghouse Electric Corp. v. Tully, supra***), and from structuring its taxes in ways which favor in-state consumers at the expense of out-of-state consumers. ***Maryland v. Louisiana***, 451 *U.S.* 725 (1981). No such distinction between in-state and out-of-state interests results from the denial of a deduction for the WPT.

In denying a deduction for "taxes paid or accrued to the United States on or measured by profits or income . . . ," *N.J.S.A.* 54:10A-4(k)(2)(C) is plainly not aimed at out-of-state transactions, businesses, activities, or consumers. The provision is thus entirely unlike the aspects of the New York stock transfer tax which provided tax benefits for transactions on New York exchanges (***Boston Stock Exchange v. State Tax Commission, supra***), and for the same reason is totally unlike the provision in the New York franchise tax which increased a corporation's D.I.S.C. credit to the extent the corporation's products were shipped from New York ports. ***Westinghouse House Electric Corp. v. Tully, supra***. As appellants properly concede, *N.J.S.A.* 54:10A-4(k)(2)(C) does not favor in-state economic activity because, since there is no crude oil production in New Jersey (J.S. 26), there is no in-state acivity to be favored.

Appellants suggest that the provision nevertheless violates the Commerce Clause because it "single[s] out for special tax burdens a form of business activity that is conducted only in other jurisdictions" (*ibid*). But that argument is foreclosed by ***Exxon Corp. v. Governor of Maryland, supra*** and ***Commonwealth Edison Co. v. Montana***, 453 *U.S.* 609 (1981). In the former case, the Court sustained a Maryland statute which prohibited a producer or refiner of petroleum products from operating a retail service station within the State. Since all of Exxon's gas which was sold in Maryland was both refined and produced outside the State, the regulation had the same effect as New Jersey's denial of a deduction for the WPT—in appellants' terms, it "singled out for special . . . burdens a form of business activity that is conducted only in other jurisdictions" (J.S. 26). Like appellants here who argue that they are discriminated against vis-a-vis nonproducer marketers which purchase their crude oil and can therefore deduct the equivalent of the WPT in their cost of goods sold, Exxon argued that the Maryland regulation burdened it while protecting Maryland independent dealers. The answer to appellants' argument here is the same as it was in the Maryland case. Some of the nonproducer marketers against whom appellants allegedly compete engage in interstate commerce just as do appellants. Consequently, the denial does not favor the in-state market at the expense of the interstate market or interstate firms. As aptly stated by the Supreme Court of New Jersey, the

distinction drawn by the application of *N.J.S.A.* 54:10A-4(k)(2)(C) to the WPT is between companies which produce crude oil and those which do not (App34a). Since the distinction does not depend on the interstate nature of appellants' businesses, there is no violation of the Commerce Clause.

Although *Exxon Corp. v. Governor of Maryland, supra* involved a state regulatory measure, the same analysis applies to a state tax. As made clear by *Commonwealth Edison Co. v. Montana, supra,* the Constitution does not prohibit a State from singling out for special tax treatment particular industries carrying on business within it. If Montana could impose a severance tax on the mining of low sulphur coal, New Jersey can deny a deduction for the WPT incurred by producers of crude oil. The mere fact that a particular tax bears more heavily on one industry than on others does not in itself establish discrimination against interstate commerce. Like Montana's coal severance tax, New Jersey's denial of a deduction for the WPT draws no distinctions based on state lines. *See* 453 *U.S.* at 618. The " 'adventitious consideration . . .' " that Montana may have a monopoly with respect to low sulphur coal is qualitatively no different for purposes of determining whether a state tax discriminates against interstate commerce than the absence of oil reserves in New Jersey.

In terms of the Equal Protection Clause, appellants are not similarly situated to marketers who do not produce crude oil, and thus the statute draws a legitimate distinction between the two classes. *See Wheeling Steel Corp. v. Glander,* 337 *U.S.* 562, 572 (1949). Further, as the Supreme Court of New Jersey correctly pointed out,

nonproducer marketers did not benefit from the decontrol of crude oil prices as did integrated producer marketers such as appellants. Instead, nonproducer marketers were forced to pay the higher unregulated price to obtain their supplies of crude oil (App34a).

In summary, denial of a deduction for the WPT neither discriminates against interstate commerce in violation of the Commerce Clause nor violates the Equal Protection Clause because the denial does not disadvantage nonresidents, out-of-state transactions, nor out-of-state consumers to the benefit of residents, in-state transactions, or in-state consumers.

CONCLUSION

For the foregoing reasons, the appeal should be dismissed, or the judgment of the Supreme Court of New Jersey should be affirmed.

Respectfully submitted,

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DATED: October 21, 1987

APPENDIX

Statute Involved

NEW JERSEY CORPORATION BUSINESS TAX ACT

§ 54:10A-4. Definitions

For the purposes of this act, unless the context requires a different meaning:

. . . .

(k) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax; provided, however, that in the determination of such entire net income,

. . . .

(2) Entire net income shall be determined without the exclusion, deduction or credit of:

(A) The amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations;

(B) Any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in paragraph (5) of subsection (k) of this section;

(C) Taxes paid or accrued to the United States on or measured by profits or income, or the tax imposed by this act, or any tax paid or accrued with respect to subsidiary dividends excluded from entire net income as provided in paragraph (5) of subsection (k) of this section;

(D) (Deleted by amendment, P.L.1985, c. 143);

(E) 90% of interest on indebtedness owing directly or indirectly to holders of 10% or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes; except that such interest may, in any event, be deducted

(i) Up to an amount not exceeding $1,000.00;

(ii) In full to the extent that it relates to bonds or other evidences of indebtedness issued, with stock, pursuant to a bona fide plan of reorganization, to persons who, prior to such reorganization, were bona fide creditors of the corporation or its predecessors, but were not stockholders or shareholders thereof;

(iii) In full to the extent that it relates to debt of a financial business corporation owed to an affiliate corporation; provided that such interest rate does not exceed 2% over prime rate; the prime rate to be determined by the Commissioner of Banking;

(iv) In full to the extent that it relates to financing of motor vehicle inventory held for sale to customers; provided said indebtedness is owed to a taxpayer customarily and routinely providing this type of financing;

(v) In full to the extent it relates to debt of a banking corporation to a bank holding company,

of which the banking corporation is a subsidiary, or to a debt of a banking corporation to another banking corporation with respect to federal funds transactions governed by section 23A of the Federal Reserve Act (12 U.S.C. § 371c.) when both banking corporation are subsidiaries of the same bank holding company, as defined in 12 U.S.C. § 1841.

(F)(i) The amount by which depreciation reported to the United States Treasury Department for property placed in service on and after January 1, 1981, for purposes of computing federal taxable income in accordance with section 168 of the Internal Revenue Code [footnote omitted] in effect after December 31, 1980, exceeds the amount of depreciation determined in accordance with the Internal Revenue Code provisions in effect prior to January 1, 1981, but only with respect to a taxpayer's accounting period ending after December 31, 1981; provided, however, that where a taxpayer's accounting period begins in 1981 and ends in 1982, no modification shall be required with respect to this paragraph (F) for the report filed for such period with respect to property placed in service during that part of the accounting period which occurs in 1981.

(ii) For the periods set forth in subparagraph (F)(i) of this subsection, any amount, except with respect to qualified mass communting vehicles as described in section 168(f)(8)(D)(v) of the Internal Revenue Code as in effect immediately prior to January 1, 1984, which the taxpayer claimed as a deduction in computing federal income tax pursuant to a qualified lease agreement under paragraph (8) of that section.

The director shall promulgate rules and regulations necessary to carry out the provisions of this section, which rules shall provide, among others, the manner in which the remaining life of property shall be reported.

No. 87-453

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

AMERADA HESS CORPORATION, *et al.*,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

On Appeal from the Supreme Court of New Jersey

BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

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BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

The state asserts a sweeping power to tax multistate businesses far beyond what this Court's decisions have sanctioned. Under its theory, a jurisdiction may freely disallow income tax deductions for costs associated with any form of economic activity that is conducted exclusively outside its borders.

The state brushes aside the territoriality and anti-discrimination principles that ordinarily constrain state taxing power. Territorial limitations, it says, have no bearing on income tax deductions: so long as the state adds nothing to the taxpayer's unitary gross receipts, the manner in which it allows or disallows deductions in

defining net income is constitutionally irrelevant, no matter how geographically tailored the deductions may be. Motion 14-15. Likewise, according to the state, constitutional protections against discriminatory state taxation do not apply in a case like this one: a state is free to impose unique tax burdens on an exclusively out-of-state business activity so long as there is no identical in-state activity that can be said to be favored. Motion 20-21.

The state's position threatens to undermine much of this Court's Due Process and Commerce Clause jurisprudence and fully justifies the concerns expressed by both groups of amici curiae. If, as New Jersey argues, a state may lawfully shape its allowable tax deductions to disfavor the exclusively out-of-state activities of a unitary business, even the most rigorous enforcement of this Court's limitations on the proper scope of a unitary business, coupled with the strictest insistence upon use of a geographically benign apportionment formula, will be powerless to deter the state from effectively taxing more than its fair share of multistate net income. And if a state may lawfully affix discriminatory tax burdens to any out-of-state activity that has no identical in-state counterpart, the free trade purpose of the Commerce Clause may easily be frustrated by the successive imposition of retaliatory tax measures that unduly penalize taxpayers on account of their exclusively out-of-state operations.

The state's position is at war with fundamental limitations on state taxing power. Its Motion reinforces the need for plenary review in this case.

1. The state does not dispute the central premises of our argument. It concedes that the WPT is a "cost" "attributable to oil production" (Motion 14), that "there is no crude oil production in New Jersey" (Motion 21), and that appellants' WPT costs therefore "have a geographic source outside" New Jersey. Motion 14. It

acknowledges that the effect of denying a WPT deduction is to "augment appellants' entire net income." Motion 19.

In our view of the case, those concessions are fatal. No state should be free to "augment" the taxable net income of a multistate taxpayer by disallowing a deduction for a significant class of costs whose "geographic source" is exclusively and necessarily outside the taxing jurisdiction. Geographic tailoring of deductions artificially inflates extraterritorial values, skews the tax base, and results in taxation beyond the state's lawful reach.

New Jersey reads the law quite differently. It acknowledges that its taxing power is subject to the "territorial constraints of the Due Process Clause" (Motion 2), and it apparently recognizes that its "net income base" must be free of "geographic bias." Motion 14. But its concept of geographic bias is eccentric. Under its theory, so long as the starting point for calculating taxable net income does not exceed the total gross receipts of a unitary enterprise, its treatment of deductions, no matter what their geographic source may be, "introduces no unconstitutional distortion to the net income base." Motion 15. But the net income base is determined by subtracting allowable deductions from gross receipts. If the deductions are geographically unbalanced, the resulting base will be geographically distorted even if the starting point of gross receipts has been determined on a permissibly neutral basis.[1]

The source of the state's apparent confusion is its reading of *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). The Court there held that a state may include in the preapportionment tax base of an integrated oil company "income derived from the extraction of oil and gas located outside the State and used

[1] As in the Jurisdictional Statement, we use "deduction" to signify any cost subtractable from either gross receipts or gross income in determining net income. *See* J.S. 7 n.7.

by the [taxpayer's] refining department." *Id.* at 210. New Jersey infers from that holding that it may both include the income from out-of-state oil production and simultaneously disregard the associated costs: "New Jersey's denial of a deduction for a cost [of oil production] which happens to have a geographic source outside the States [*sic*] does not distort the base to any greater degree than does inclusion of [oil production] income from a non New Jersey source." Motion 14.

That view of the case would convert *Exxon* into a tax collector's bonanza, allowing each jurisdiction to tax out-of-state income unencumbered by out-of-state costs. But nothing in this Court's opinion suggests that a state may properly separate production income from associated production costs, pulling the income into the state while leaving the costs behind. On the contrary, the Court plainly assumed that unitary "costs and charges" were inseparable from unitary income. 447 U.S. at 221.

The state's approach, moreover, cannot be squared with this Court's "internal consistency" test. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983). If every jurisdiction, following New Jersey's example, were to disallow a deduction for out-of-state oil production costs, an integrated oil company conducting a nationwide business would be taxed on far more than 100 percent of its unitary net income. Each state, whether producing or non-producing, would claim its apportioned share of production income, but production costs would be orphaned, allowed as an apportioned offset to income only by the state in which they were incurred.

New Jersey apparently believes that the courts are powerless to remedy the geographic distortions inherent in its tax scheme unless appellants demonstrate that "denial of a deduction for the WPT results in an irrational *amount* of their income being subjected to tax." Motion 14 (emphasis in original). The record here amply

satisfies that standard. New Jersey, through the operation of its add-back provision, dramatically increased the amount of appellants' taxable income and state tax liability. J.S. App. 84a.[2]

More fundamentally, however, the flaw in New Jersey's scheme is qualitative, not merely quantitative. When a taxpayer complains about a particular application of an otherwise structurally sound state apportionment mechanism, it may properly be held to a high standard of proof concerning the degree of distortion. *See Container*, 463 U.S. at 170. But where, as here, a state's mechanism is structurally defective, so that it necessarily distorts the net income base of every integrated oil company, the standard is different. Just as the Court "need not know how unequal [a tax] is before concluding that it unconstitutionally discriminates," *Maryland v. Louisiana*, 451 U.S. 725, 760 (1981), it need not know how unfair New Jersey's geographically tailored deduction is before concluding that the state's approach is "inherently arbitrary." *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

It is no more "unworkable" (Motion 15) to insist on geographically neutral income tax deductions than to require geographically fair net income apportionment formulas. In each case, the states enjoy a generous "margin of error" when they apply intrinsically even-handed principles to individual taxpayers. *Container*, 463 U.S. at 184. But states should have no greater freedom in their treatment of deductions than in their framing of apportionment formulas to adopt intrinsically unfair schemes that inevitably exaggerate the share of multistate income reasonably attributable to the taxing jurisdiction.

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[2] We are mystified by the state's repeated attack on our use of the phrase "add-back provision." Motion 8, 18. The source of the phrase is the opinion of the New Jersey Supreme Court. J.S. App. 2a.

Under these principles, a state may properly disallow a deduction for costs that are as likely to be incurred inside as outside the state. Interest payments to 10 percent shareholders—an example to which the state refers (Motion 15)—may well fall in that category, for there is no apparent reason to expect that all such payments have a geographic source outside New Jersey. That a particular taxpayer's interest payments in a given year may in fact have an out-of-state source would neither negate the structural fairness of the disallowance nor necessarily invalidate its application to that taxpayer.

What a state cannot do, however, is disallow a deduction for a substantial class of costs that are incurred exclusively or overwhelmingly outside the state's borders. New Jersey's treatment of WPT costs falls clearly in that category. It requires no individualized scrutiny of each taxpayer's circumstances to determine that the disallowance of such inherently out-of-state costs impermissibly distorts the net income tax base.

2. The state argues that the Commerce Clause provides no protection against New Jersey's discriminatory imposition of a unique tax burden on out-of-state oil production activities. Its theory is simple. The Commerce Clause, it says, has no application unless an in-state business activity is favored over an identical out-of-state activity. Motion 20. The add-back provision "does not favor in-state economic activity because, since there is no crude oil production in New Jersey . . . , there is no in-state ac[t]ivity to be favored." Motion 21.

New Jersey's argument trivializes the Commerce Clause, transforming it, in the words of amici Committee on State Taxation *et al.*, into a mere "equal rights act as between local and interstate industries." Br. 14. But the Commerce Clause has the more profound purpose of preserving "a free trade area among States." *American Trucking Ass'ns, Inc. v. Scheiner*, 107 S. Ct. 2829, 2839 (1987). The imposition of special tax burdens on an

out-of-state business activity "implicates central Commerce Clause values" (*id.*) regardless of whether the identical activity is carried on within the state. Like the unapportioned flat tax in *American Trucking Ass'ns*, New Jersey's add-back provision fails "the internal consistency test" and has the "inevitable effect" of inhibiting free trade. *Id.* at 2840. If each state were to attach special tax burdens to exclusively out-of-state business activities, multistate companies that engage in those activities would necessarily bear higher tax costs than intrastate companies with whom they compete. Imposing such economic handicaps on interstate companies solely because of their out-of-state business is incompatible with the free trade purposes of the Commerce Clause.

The state sees in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981), authorization to "singl[e] out for special tax treatment particular industries carrying on business within it." Motion 22. But the state has the case backwards. The Court upheld Montana's coal severance tax precisely because the severance occurred only in Montana. Nothing in the decision supports New Jersey's perverse claim that it can impose special tax burdens on oil production activities that occur only outside the state.[3]

3. The state's effort to belittle the importance of this case rings hollow. One cannot credibly argue that the geographical tailoring of income tax deductions is immune from constitutional scrutiny, and that states may lawfully force out-of-state business activities to bear unique tax burdens, but then suggest in the next breath that this case "does not have national ramifications." Motion 10. The power claimed by the state is extraordi-

[3] We explained in the Jurisdictional Statement (at 29) why *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), on which the state also relies (Motion 21-22), gives New Jersey no license to single out for disfavored tax treatment economic activity that occurs only outside its borders.

nary. As the amici have shown, the principles at issue here have grave implications for a broad range of geographically localized business activities.

The state suggests that the case does not warrant this Court's full attention because New Jersey's "revenue gains [attributable to the add-back provision] are minute by comparison to total WPT paid to the federal government." Motion 10 n.7. And it implies inaccurately that WPT payments are a tiny fraction of appellants' total deductions. Motion 18. The fact remains, however, that the state stands to collect nearly $100 million in additional tax receipts as a result of the decision below (*see* J.S. 14) and that the state's interpretation of the add-back provision has increased appellants' tax liabilities by substantial, in some cases enormous, percentages.

The Court should note probable jurisdiction.

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October 1987

(1) (6)

Nos. 87-453 and 87-464

In the Supreme Court of the United States

OCTOBER TERM, 1987

AMERADA HESS CORP., ET AL., APPELLANTS

v.

DIRECTOR, DIVISION OF TAXATION

TEXACO, INC. AND TENNECO OIL CO., APPELLANTS

v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY

ON APPEALS FROM THE SUPREME COURT OF NEW JERSEY

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution permit New Jersey, in defining the company-wide net income that is subject to apportionment for the State's corporate income tax, to disallow a deduction for crude oil windfall profit taxes paid to the United States.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

A. Since 1980, oil producers like appellants have been subject to the federal crude oil "windfall profit" tax imposed under Section 4986 of the Internal Revenue Code (I.R.C. or Code) (26 U.S.C.). The tax was created by the Crude Oil Windfall Profit Tax Act of 1980, I.R.C. §§ 4986-4998, in conjunction with the removal of federal ceilings on oil prices. The federally controlled price of domestic oil at the time ranged from \$5.86 to \$13.06 per barrel, while the world market price had risen to

nearly $20 per barrel. When President Carter decided to decontrol prices, he and the Congress also determined that the resulting "windfall" to oil producers should be subject to a special "windfall profits" tax. H.R. Rep. 96-304, 96th Cong., 1st Sess. 4-7 (1979); S. Rep. 96-394, 96th Cong., 1st Sess. 6-8 (1979); Windfall Profits Tax and Energy Security Trust Fund, 15 Weekly Comp. Pres. Doc. 721-727 (Apr. 26, 1979); *United States* v. *Ptasynski,* 462 U.S. 74, 76 (1983). Rather than levy a special tax on increased company-wide net income, however, the President and Congress chose to impose an "excise tax" on the increase in value of each barrel of crude oil at the wellhead (I.R.C. § 4986; 15 Weekly Comp. Pres. Doc. at 723), evidently intending by that method to simplify the enforcement of the tax and to minimize the possibility of noncompliance (see H.R. Rep. 96-304, *supra,* at 43; S. Rep. 96-394, *supra,* at 66-67).

The event that triggers imposition of the tax is removal of oil from the oil-producing premises, which may occur by sale of the oil, by its on-site refining, or by its transportation away for use in another part of the producer's business. I.R.C. §§ 4986(a), 4988(c). The figure to which the tax is applied, or the measure of the tax (the "windfall profit"), is generally the increase in value of the oil at the wellhead due to decontrol—the difference between (i) the "removal price," which is the actual or constructive sale price at the premises after decontrol (I.R.C. § 4988(c)), and (ii) the "adjusted base price" plus the state "severance tax adjustment," which is the approximate price of the oil prior to decontrol, adjusted for inflation, plus the increase in state severance taxes caused by the higher prices resulting from decontrol (I.R.C. §§ 4989, 4996(c)). I.R.C. § 4988(a).[1] To avoid burdening high-cost production (H.R. Rep. 96-304, *supra,* at 2; S. Rep. 96-394, *supra,* at 29), however, the measure of the tax on each barrel may not exceed 90% of the "net income" from the barrel, which is determined property by property and which, when there is no on-site sale, is based on the market price at the property at the time of removal. I.R.C. § 4988(b); 26 C.F.R.

The Act assigns different base prices to different types (or "tiers") of oil. See I.R.C. §§ 4989(c) and (d), 4991.

1.613-3(a). (Accordingly, it is possible for an oil producer to incur substantial windfall profit tax liability even though its company-wide net income, calculated even without subtracting the windfall profit tax, is zero or negative.)[2] The rate of the tax for the years at issue in these cases, 1980 and 1981, varied from 30 to 70%, depending on the type of oil being produced. I.R.C. § 4987.[3]

In addition to the windfall profit tax, oil-producing corporations like appellants are subject to the federal corporate income tax under Section 11 of the Code. "Since the windfall profits tax is an excise tax, it is deductible for income tax purposes." 15 Weekly Comp. Pres. Doc. at 723. Although the tax paid to the United States on removal of oil from the production premises would generally be deductible as a business expense under Section 162 or 212 of the Code even without separate statutory authorization (see H.R. Rep. 96-304, *supra,* at 14 ("[t]he windfall profit tax is a deductible business expense under the income tax"); 26 C.F.R. 1.164-3(f)), Congress explicitly provided in Section 164(a)(5) for the deductibility of that amount even where it is not a business expense. "Such a deduction is consistent with the usual treatment of excise taxes and prevents

[2] Assume, for example, that a company consisted entirely of two producing properties, A and B; that A produced a profit of 100, of which 40 was windfall profit; that B produced a loss of 100; and that the applicable windfall profit tax rate was 50%. Then the windfall profit tax would be 20 on A and 0 on B, while the company's net income would be 0 (100 on A minus 100 on B) without subtracting the windfall profit tax liability. If the loss on B were 200 in the same example, the windfall profit tax liability would remain 20, and the company-wide net income (without subtracting that liability) would be −100. Cf. Pltf. Jt. App. 616a-658a (In 1981, appellant Cities Service had a windfall profit tax liability of more than $300,000,000 but only about $14,000,000 in federal taxable income on line 28 of the federal return, arrived at after subtracting the windfall profit tax liability.); J.S. App. 84a (In 1981, appellant Cities Service would have incurred no New Jersey income tax liability if the windfall profit tax had been excluded from New Jersey's income tax base.).

Unless otherwise noted, "J.S. App." refers to the appendix to the jurisdictional statement in No. 87-453.

[3] Some of the rates have decreased since 1981, and the tax is to be eliminated by 1993. I.R.C. §§ 4987(b)(3), 4990(c).

the imposition of combined income and excise taxes in excess of the taxpayer's gross windfall profit." S. Rep. 96-394, *supra*, at 68; see H.R. Rep. 96-304, *supra*, at 43-44. The portion of the "windfall profit" remaining after subtraction of the windfall profit tax paid to the Government is joined with the company's other income and made subject to federal income tax.

B. The State of New Jersey imposes a corporation business tax on the apportioned share of a corporation's "entire net income" for the privilege of "doing business, employing or owning capital or property, or maintaining an office" in the State. N.J. Stat. Ann. §§ 54:10A-2, 54:10A-8 (West 1986).[4] For taxpayers doing business in more than one State, the tax liability is determined by multiplying (a) the taxpayer's company-wide "entire net income" by (b) a fraction representing the share of the taxpayer's income properly apportioned to New Jersey by (c) the tax rate (nine percent). *Id.* § 54:10A-5(c). The apportionment fraction — which, like the tax rate, is not challenged — is derived by the standard three-factor formula averaging the ratios of in-State to out-of-State payroll, receipts, and real and tangible property. *Id.* § 54:10A-6. The "entire net income" of a multistate corporation is presumptively the same as the federal taxable income on line 28 of the federal tax return (*id.* § 54:10A-4(k)), but a number of modifications to that figure are required under the so-called "add-back" provision. In particular, the "entire net income" subject to apportionment " shall be determined without the * * * deduction * * * of * * * [t]axes paid or accrued to the United States on or measured by profits or income" (*id.* § 54:10A-4(k)(2)(C)).[5]

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[4] For the years at issue in these cases, the state tax was also imposed on a similarly apportioned share of taxpapers' "entire net worth." N.J. Stat. Ann. § 54:10A-5(a) (West 1986). That portion of the tax is not at issue in these cases.

[5] The New Jersey Supreme Court stated that the provision requiring modification of federal taxable income to arrive at entire net income "is called the 'add-back' provision" (J.S. App. 2a). This is an accurate short-hand description of the way entire net income is calculated: the windfall profit tax is added back to the federal line-28 taxable income. Of course, the constitutional analysis in these cases turns on the actual operation of the provision, and not on its label.

C. Appellants are vertically integrated oil companies that engage in all aspects of the crude oil business, including exploration, production, refining, and marketing. All market their petroleum products and some refine oil in New Jersey; all produce oil outside of New Jersey. Neither appellants nor any other companies produce oil in New Jersey, which has no proven oil reserves. J.S. App. 2a; Comm. on State Taxation et al. Amici Br. 5 n.2.

In reporting their "entire net income" to New Jersey for 1980 and 1981, appellants did not add back to their federal taxable income the windfall profit taxes they had paid to the United States, taxes they had properly deducted in calculating their federal taxable income. New Jersey's Director of the Division of Taxation, appellee in these cases, required the inclusion of the windfall profit tax amounts in the entire net income on the ground that the windfall profit tax was a tax "on or measured by profits or income" under N.J. Stat. Ann. § 54:10A-4(k)(2)(C) (West 1986). The companies thereafter brought suit in the Tax Court of New Jersey, contending that the federal windfall profit tax did not come within the New Jersey add-back provision and that it could not do so without violating the federal Constitution or frustrating the policies of the Crude Oil Windfall Profit Tax Act of 1980. J.S. App. 6a-7a; 87-453 J.S. 8-9; 87-464 J.S. 4-5.

The Tax Court of New Jersey upheld the deficiency assessments of the Director (J.S. App. 43a-49a, 50a-61a). The Superior Court of New Jersey, Appellate Division, reversed the Tax Court on state-law grounds (*id.* at 36a-42a). The Supreme Court of New Jersey reversed and reinstated the judgment of the Tax Court. (*id.* at 1a-35a).

The state Supreme Court devoted most of its opinion to explaining why, as a matter of state law, the windfall profit tax was a tax "on or measured by profits or income" and was therefore not deductible in defining the "entire net income" subject to apportionment (J.S. App. 10a-31a). The court observed that the add-back provision had been enacted in 1958, long before the federal windfall profit tax was created, so that there was no specific legislative intent towards the federal tax (*id.* at 3a). The court then reasoned that the federal tax was "measured

by profits or income" both literally and economically. The windfall profit tax, the court concluded, was imposed on a part of true net income (*i.e.*, receipts minus costs): first, the measure of the tax could not exceed 90% of the per-barrel net income; and in any event, the measure of the tax was only the excess over the controlled price, which was itself apparently adequate to ensure cost recovery to appellants. *Id.* at 16a-29a.

On the federal questions presented, the court ruled that the 1980 Act did not preempt application of the add-back provision to the windfall profit tax (J.S. App. 34a-35a)[6]; the court then rejected appellants' due process, Commerce Clause, and equal protection challenges. The court rejected the due process challenge simply by noting that appellants conceded that they were unitary businesses, that only a deduction from and not an addition to the "net income tax base" was at issue, and that the three-factor apportionment formula reduced the tax base to what was properly attributable to New Jersey (*id.* at 33a-34a). With respect to the Commerce Clause, the court held that there was no violation because denying a deduction for the windfall profit tax "does not favor in-state over out-of-state economic activity" or otherwise "discriminate against interstate commerce" (*id.* at 34a). Finally, the court concluded that appellants had not been denied equal protection relative to non-producing marketers, explaining that the latter did not pay the windfall profit tax, did not benefit from decontrol, and indeed had to pay higher prices in purchasing crude oil (*ibid.*).

DISCUSSION

A. This Court has noted that the Constitution imposes " 'extremely limited restrictions' " on States' powers of taxation. *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 457 (1959) (citation omitted). Those restrictions cluster around two related principles – that States are forbidden to impose extraterritorial taxes or taxes that discriminate against interstate commerce. In its numerous decisions in this area, the Court has articulated in various ways how those principles apply

[6] Appellants have not renewed that argument in this Court.

in different contexts, noting that "the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case" (*Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 329 (1977)).

1. The Due Process and Commerce Clauses require a State to limit its taxes to in-State values: "As a general principle, a State may not tax value earned outside its borders." *ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982); see *Connecticut Gen. Life Ins. Co.* v. *Johnson*, 303 U.S. 77, 81 (1938); *Western Union Tel. Co.* v. *Kansas*, 216 U.S. 1, 26-27, 35, 37-38, 47 (1910). This principle requires, most basically, "a 'minimal connection' or 'nexus' between the interstate activities and the taxing State." *Exxon Corp.* v. *Department of Revenue*, 447 U.S. 207, 219 (1980); see *Tyler Pipe Industries, Inc.* v. *Washington State Dep't of Revenue*, No. 85-1963 (June 23, 1987), slip op. 16-17; *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 436-437 (1980); *Moorman Mfg.* v. *Bair*, 437 U.S. 267, 273 (1978); *Northwestern Cement*, 358 U.S. at 464-465. In addition, the measure of a State's tax must be rationally related to the taxpayer's in-State activities (and hence to the protections and benefits afforded by the State). *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 622-626 (1981); *Moorman Mfg.*, 437 U.S. at 273; *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977); *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444 (1940). A tax imposed on a multistate business must accordingly be so limited as to tax only business that is fairly attributable to the State: the tax must be fairly apportioned. *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159, 171 (1983); *Exxon Corp.*, 447 U.S. at 220; *Complete Auto*, 430 U.S. at 279; *Butler Bros.* v. *McColgan*, 315 U.S. 501, 506-507 (1942); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920); *Western Union*, 216 U.S. at 30-31.

In one important line of decisions that apply those principles to taxes that fall on multistate businesses, the Court has addressed the potential for multiple taxation by holding or stating that certain transactions or events are so inherently locale-specific as not to be subject to taxation by more than one State.

Thus, the Court has indicated that only the State where the activity of selling takes place may tax the activity itself at its full value—namely, gross receipts from the sale. *Tyler Pipe*, slip op. 18 (citing *Moorman Mfg.*, 437 U.S. at 280-281; *Standard Pressed Steel Co.* v. *Washington Revenue Dep't*, 419 U.S. 560, 564 (1975)). The Court has also observed that the activity of severance of coal is subject to taxation on its full value—the value of the coal—only in the State where the coal is mined. *Commonwealth Edison*, 453 U.S. at 617. See also *Evco* v. *Jones*, 409 U.S. 91 (1972). Apportionment problems are cured, of course, if only one State may tax a particular activity in that State.

The more common way of addressing apportionment problems raised by taxes on multistate businesses' *income* is use of the formula-apportionment method of determining each State's proper share of the income. Under this method, a State begins with company-wide income (from some or all sources) and multiplies that figure by a fraction used to approximate the local share of business. This Court has generally upheld that method against broad claims that it allows States to tax too much or insufficiently related income.

Thus, the Court has permitted inclusion in the formula of all company income—out-of-State and in-State, foreign and domestic—even when the company keeps separate accounts for different sources of income and even when the business is not a single corporation. See *Container Corp.*, 463 U.S. at 175-183 (upholding inclusion of foreign income); *Exxon Corp.*, 447 U.S. at 220-230 (upholding apportionment formula even though company used separate accounting for production, refining, and marketing, only last of which occurred in the taxing State); *Mobil Oil Corp.*, 445 U.S. at 438-448 (upholding inclusion of dividend income); *Northwestern Cement*, 358 U.S. at 459 (upholding inclusion of income from interstate commerce); *Underwood Typewriter*, 254 U.S. at 116-120.[7] The Court has

[7] At the same time, the Court has not forbidden separate accounting in preference to formula apportionment. In *Atlantic Richfield Co.* v. *Alaska*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 474 U.S. 1043 (1986), the Alaska Supreme Court rejected several challenges to Alaska's taxing scheme, which

approved general use of the common three-factor fraction (receipts, wages, and real and tangible property) (see *Container Corp.*, 463 U.S. at 170) and of certain single-factor fractions (*Moorman Mfg.*, 437 U.S. 267 (sales); *Underwood Typewriter*, 254 U.S. 113 (property)).

The Court has insisted, however, that the formula-apportionment method may be applied only to the income from a "unitary" business: the formula may not include income from a "discrete business enterprise" (*Mobil Oil Corp.*, 445 U.S. at 439-441) or from otherwise unrelated activities of the taxpayer. See *Container Corp.*, 463 U.S. at 166; *Exxon Corp.*, 447 U.S. at 223-226; *ASARCO Inc.*, 458 U.S. 307; *F. W. Woolworth Co.* v. *Taxation & Revenue Dep't*, 458 U.S. 354 (1982). The Court has long recognized that if, but only if, a business is unitary, it is likely impossible (as a practical and perhaps even theoretical matter) to determine the geographic source of particular net income, because all activities of an integrated business make some contribution to the production of income throughout the business. *Container Corp.*, 463 U.S. at 164; *Butler Bros.*, 315 U.S. at 506-507; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, 266 U.S. 271, 282 (1924). Accordingly, although the formula-apportionment method is inherently imprecise and States' use of different formulas may produce some multiple taxation (see *Container Corp.*, 463 U.S. at 171, 183, 187; *Moorman Mfg.*, 437 U.S. at 278), the Court has required taxpayers complaining that unfair apportionment has resulted in the taxation of extraterritorial values to show "by 'clear and cogent evidence' " that the income attributed to the State is " 'out of all appropriate proportion[ ]' " to the business transacted in the State (*Moorman Mfg.*, 437 U.S. at 274; see *Exxon Corp.*, 447 U.S. at 220; *Butler Bros.*, 315 U.S. at 507). See also *Hans*

excluded oil production income from the general formula-apportionment method and imposed a separate income tax on such income. The taxpayers appealed on the ground, among others, that the Constitution prohibited separate accounting for production income and required it to be included in the apportionment formula. 85-773 J.S. i. The Court dismissed the appeal for want of a substantial federal question, with three Justices dissenting. 474 U.S. 1043 (1986).

Rees' Sons v. *North Carolina ex rel. Maxwell,* 283 U.S. 123 (1931) (State may not tax 66-85% of income where only 17% is properly attributed to the State).

2. The Commerce Clause, along with the Equal Protection Clause and the Privileges and Immunities Clause of Article IV, prohibits certain forms of discriminatory taxation that place obstacles in the way of interstate commerce. See *Container Corp.*, 463 U.S. at 171; *Complete Auto,* 430 U.S. at 279; *Western & Southern Life Ins. Co.* v. *State Bd. of Equalization,* 451 U.S. 648, 655, 667-668 (1981); *Travis* v. *Yale & Towne Mfg.*, 252 U.S. 60 (1920). Thus, this Court has struck down state laws that discriminate against non-residents, that impose higher taxes when a transaction crosses state lines than when it is purely intrastate, that give a commercial advantage to businesses by virtue of their in-State activities or disadvantage by virtue of their out-of-State activities, or that otherwise place an "inexorable hydraulic pressure on interstate businesses to ply their trade within the State." *American Trucking Ass'ns, Inc.* v. *Scheiner,* No. 86-357 (June 23, 1987), slip op. 19. See *Northwestern Cement,* 358 U.S. at 458. Although States may impose taxes on interstate businesses and may justify certain kinds of different treatment, they may not impair the constitutional "guarantee of a free trade area among States" by imposing a tax that "has a clearly discriminatory effect on commerce by reason of that commerce's interstate character" (*American Trucking Ass'ns, Inc.*, slip op. 13, 28-29).

For example, in *Boston Stock Exchange* v. *State Tax Comm'n, supra,* a State, as part of its tax on in-State stock transfers made after stock sales, granted non-residents a 50% tax reduction if the sale (as well as the transfer) took place in-State and placed a ceiling on total transfer tax liability for all in-State sales. The Court held the tax unlawfully discriminatory because it provided an incentive for all non-residents and for some residents (those whose sales would exceed the ceiling) to divert their out-of-State sales into the State (429 U.S. at 330-336).[8] In *Maryland* v. *Louisiana,* 451 U.S. 725 (1981), the

[8] Discrimination against non-residents was also struck down in *Wheeling Steel Corp.* v. *Glander,* 337 U.S 562 (1949), where the Court invalidated a

Court invalidated a natural-gas tax from which in-State users were at least partly exempt, finding that the tax had the obvious effect of encouraging more in-State activity (*id.* at 756-757). In *Westinghouse Electric Corp.* v. *Tully,* 466 U.S. 388 (1984), the Court held invalid a provision of a state income tax that allowed a credit to certain taxpayers if they shipped certain foreign-destination goods from the taxing State rather than from another State. The Court observed that the tax plainly attempted to induce business to be performed in the State that might more efficiently be performed elsewhere (*id.* at 406-407), that there was no economic difference between merely denying a credit to certain taxpayers and raising their taxes (*id.* at 404-405), and that the discrimination bar applied even if the state tax otherwise included a fair apportionment formula (*id.* at 398-399). In *Metropolitan Life Ins. Co.* v. *Ward,* 470 U.S. 869 (1985), the Court held that a State could not validly impose lower taxes on in-State insurance companies or give tax breaks based on in-State investments in order to encourage the formation of in-State companies or investment in in-State assets.[9]

Most recently, in *Tyler Pipe Industries, Inc.* v. *Washington State Dep't of Revenue, supra,* this Court struck down a tax that granted a manufacturing-tax break to in-State manufacturers, but not to out-of-State manufacturers, who sold their goods wholesale in the State. Noting that the tax break could not be defended as compensation for double taxation because no account was taken of out-of-State manufacturing taxes (slip op. 9-10, 16), the Court held that this "facially discriminatory" tax failed the test of "internal consistency": if applied by all States,

state tax on non-residents' accounts receivable from in-State business, rejecting the State's reciprocity defense that other States might treat their residents similarly (*id.* at 573). See also *Williams* v. *Vermont,* 472 U.S. 14 (1985).

[9] In *Western & Southern Life Ins. Co.* v. *State Bd. of Equalization,* 451 U.S. 648 (1981), by contrast, after explaining that the McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq.*, removed any passive Commerce Clause limitations on state insurance taxes, the Court rejected an equal protection challenge to a state insurance tax, explaining that the tax was legitimately designed to discourage other States from erecting barriers to interstate insurance business.

business that crosses state lines would be subject to higher taxes than purely intrastate businesses (*id.* at 14-15). See also *Armco Inc.* v. *Hardesty*, 467 U.S. 638 (1984). And in *American Trucking Ass'ns, Inc.* v. *Scheiner, supra*, the Court struck down a State's flat tax on all trucks that used the State's roads, where out-of-State truckers on average used the roads only one-fifth as much as in-State truckers (slip op. 8-9, 29). The Court observed that a State may not impose a "heavier tax burden on out-of-State businesses that compete in an interstate market than it imposes on its own residents who also engage in commerce among States" (*id.* at 15 (footnote omitted)). Although the tax was not facially discriminatory and not all out-of-State truckers suffered the disproportionately higher per-mile tax than all in-State truckers (*id.* at 18-19), the Court held the tax invalid because it failed the internal consistency test: if applied by all States, it would inevitably deter interstate business, because two truckers traveling the same number of miles would pay different taxes depending solely on whether they crossed state lines (*id.* at 17).[10]

B. 1. We begin our analysis of appellants' claim by noting all that is not at issue in these cases. Appellants do not challenge the appropriateness of the State's use of the unitary-business formula-apportionment method for its corporate income tax or the State's selection of the three-factor payroll/property/receipts apportionment fraction. They do not deny that their oil-producing operations are parts of unitary businesses that have a sufficient connection with the State. See *Exxon Corp.* (integrated petroleum businesses unitary); *Mobil Oil Corp.* (same). Nor do they challenge the New Jersey taxing scheme as "facially discriminatory," since the State has not expressly rested any feature of its tax on the in-State or out-of-State character of companies, transactions, or goods. Compare *Tyler Pipe*; *Westinghouse Electric Corp.*; *Maryland* v. *Louisiana*; *Boston Stock Exchange*.

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[10] See, *e.g.*, *Tyler Pipe*, slip op. 12-15; *Container Corp.*, 463 U.S. at 170; *Moorman Mfg.*, 437 U.S. at 275-278; *Northwestern Cement*, 358 U.S. at 458; *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U.S. 434, 439 (1939); *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 255 (1938).

Despite some characterizations that might suggest otherwise,[11] appellants do not expressly raise an intent-based challenge to the New Jersey decision at issue here, and we doubt that any such challenge could succeed. First, it is the federal government that first "singled out" those who produce oil for special tax treatment. Moreover, the New Jersey add-back provision, which applies to all federal taxes measured by profits or income, is certainly "unobjectionable on its face" (87-453 Mot. to Aff. 9), and the state legislature had no intent towards the windfall profit tax, which was enacted long after the add-back provision (J.S. App. 3a). Finally, the New Jersey Supreme Court construed the provision as it did because of its view that the windfall profit tax was indeed measured by profits and that disallowing its deduction preserved for New Jersey the same full net-income base that the federal government taxes (albeit in two stages – first, the windfall profit tax, then the income tax) (*id.* at 16a-29a). In short, there is no reason to suspect any local favoritism, protectionism, or other motivation that may justify special judicial scrutiny.

This conclusion is reinforced by the fact that, although New Jersey's method of calculating entire net income results in a distinction between integrated oil companies, which produce oil, and the non-producing independent marketers with which they compete, that distinction does not *coincide* with an in-State/out-of-State distinction. Appellants do not dispute that there are independent marketers that are out-of-State companies and that are engaged in interstate business, as in *Exxon Corp.* v. *Maryland*, 437 U.S. 117 (1978). And appellant integrated producers have very substantial presences in New Jersey, including refining and chemical operations (see Pltf. Jt. App. 1129a-1137a).[12]

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[11] Appellants state that New Jersey has geographically "tailored" its tax (87-453 J.S. 12, 15, 17, 18), has "gerrymander[ed]" its tax base (*id.* at 12), has "single[d] out" certain out-of-State activity for special treatment (*id.* at 17, 19, 26), has "tamper[ed] in a geographically selective manner" with its tax base (*id.* at 13).

[12] At least one appellant, Exxon Corporation, is a New Jersey corporation. Pltf. Jt. App. 1134a.

Further, the facially neutral deduction denial at issue here does not create either of two forms of discrimination against interstate commerce that were created by the statutes struck down in *Boston Stock Exchange*, *Maryland* v. *Louisiana*, *Westinghouse Electric Corp.*, and *Tyler Pipe*. First, the New Jersey decision at issue cannot produce an incentive for appellants to move their out-of-State oil production activity into the State, because oil production cannot be moved into a State with no proven reserves. Second, if all States followed New Jersey's treatment of windfall profit taxes, oil producers would not thereby be given an incentive to confine oil production to a single State. Producers would, of course, be taxed on a higher base than if all States allowed the deduction; but the same overall level of oil production would create the same tax base (all other things being equal) whether it took place in several States or in one. The New Jersey add-back of windfall profit taxes thus passes at least that version of the internal consistency test.[13]

2. Appellants contend that New Jersey has geographically skewed the definition of pre-apportionment net income by denying a deduction for a "business expense" or "cost" (*e.g.*, 87-453 J.S. 12, 18) that is incurred on account of a locale-specific activity (oil production) that neither appellants nor any other New Jersey taxpayer conducts in the State.[14] Disallowing the deduction, they urge, effectively imposes a state tax,

[13] The Court has not suggested that the internal consistency test is the sole test of constitutionality. Moreover, in *Container Corp.*, 463 U.S. at 169, the Court described the "internal consistency" test as asking whether a tax, "if applied by every jurisdiction, * * * would result in no more than all of the unitary business' income being taxed." To the extent appellants are correct that windfall profit taxes represent a true economic cost, New Jersey's denial of the deduction for the taxes would mean that it was taxing more than its share of true net income; and if all States followed New Jersey's lead, even with fair apportionment, appellants would be subject to aggregate taxation on more than 100% of their true net income. The same result would occur, however, if the business were located wholly in one State. Whether there is nonetheless a constitutional problem we discuss below.

[14] Throughout this brief, we use the term "geographic skewing" or "geographically skewed" to refer to disparities between in-State and out-of-State effects.

triggered by the activity of removing oil from out-of-State producing properties, on a "percentage of the value of the crude oil produced in another state" (87-453 J.S. 23), as if New Jersey had imposed its own apportioned windfall profit tax on the activity of out-of-State oil production (*id.* at 21; 87-464 J.S. 16-17). This violates extraterritorial principles, they say, because the taxed activity of "removal" has no nexus to New Jersey, the measure of the tax (a portion of value at the producing property) bears no fair relationship to appellants' New Jersey activities, and denying a deduction for an exclusively out-of-State "cost" results in an unfair apportionment to New Jersey of unitary income. See 87-453 J.S. 18-24; 87-464 J.S. 9-17. Discrimination principles are also violated, appellants argue, because New Jersey has imposed a higher tax burden on some taxpayers because of their out-of-State activities, with the direct result that appellants' non-producing competitors in marketing are subject to a lower effective rate than are appellants (87-453 J.S. 24-30).

3. Appellants' challenge does not fall neatly into the doctrinal categories elaborated by this Court. This Court's decisions indicate, however, that a state tax measure may in some circumstances violate the Constitution because of its formal operation (its incidence, measure, and rate) and its economic effects, even though it is not facially discriminatory or ill-motivated.[15] Whatever the proper label for their claim, and whatever its ultimate merits, appellants' challenge raises a federal question worthy of plenary review by this Court.[16]

[15] See *American Trucking Ass'ns*, slip op. 18-19, 29; *Tyler Pipe*, slip op. 18; *Commonwealth Edison Co.*, 453 U.S. at 615; *Maryland* v. *Louisiana*, 451 U.S. at 756; *Exxon Corp.*, 447 U.S. at 227-228; *Mobil Oil Corp.*, 445 U.S. at 443; *Complete Auto*, 430 U.S. at 279, 281; *Shaffer* v. *Carter*, 252 U.S. 37, 55 (1920); *Western Union*, 216 U.S. at 27.

We also note that three of the seven other States in which the question presented here has arisen (Minnesota, North Dakota, and Wisconsin) have expressly denied a deduction for the windfall profit tax in their statutes. See J.S. App. 85a-91a.

[16] The immediate practical importance of these cases is apparently limited to the precise question of the deductibility of the windfall profit tax. More than $88 million is at stake for New Jersey (87-453 Mot. to Aff. 11 n.8) and

a. Appellants correctly suggest that a State's facially neutral denial of a deduction for a particular site-specific cost that was and could be incurred only out-of-State would raise substantial constitutional questions. This Court's decisions on the unitary-business formula-apportionment method have considered what parts of a business, with all associated receipts and costs, may fairly be included in pre-apportionment income; and in that context, it has rejected challenges based on geographic skewing. *E.g.*, *Container Corp.*; *Exxon Corp.*; *Mobil Oil Corp.*; see also *Atlantic Richfield Co.* v. *Alaska*, 474 U.S. 1043 (1986) (dismissing appeal). But the Court has not previously been presented with a claim like appellants' – that a State has asymmetrically included receipts without allowing deductions for associated costs. The Court has, however, noted that a tax "tailored" to give special treatment to particular businesses (*e.g.*, those which incur particular costs) raises special dangers of invalidity and demands special judicial scrutiny (*Complete Auto*, 430 U.S. at 288 n.15). (As we have noted (page 13, *supra*), there is no intentional *legislative* tailoring here, but the law at issue may operate with the same effect.)

Although the several pertinent constitutional requirements this Court has articulated – nexus of the taxed activity to the State, fair relationship to the State of the measure of the tax, fair apportionment, and non-discrimination (see *Commonwealth Edison*, 453 U.S. at 626; *Complete Auto*, 430 U.S. at 279) – are related, the constitutional difficulty with denying a

several times that amount for the seven other States where the question has arisen (J.S. App. 85a-91a). We also think it appropriate to disclose that, because state income taxes are deductible for federal tax purposes (I.R.C. § 164), the United States has a large financial interest in these cases directly adverse to that of the State.

Aside from the windfall profit tax, appellants and their amici correctly argue that the ruling of the New Jersey Supreme Court increases the likelihood that States will deny deductions for other exclusively out-of-State site-specific costs. Appellants' amici express concern, in particular, that States might begin denying deductions for federal taxes or other States' taxes on the activity of severing minerals from the ground or on harbor use, both obviously site-specific. Comm. on State Taxation et al. Amici Br. 7-11; Amer. Min. Cong. Amicus Br. 5-8. Amici do not point to any State that has adopted such practices.

deduction for a site-specific cost does not seem to us a problem of insufficient nexus of the taxed activity to the State or unfair relation of the measure of the resulting tax to State benefits. In this regard, the problem is different from that presented by one State's directly taxing severance or sales in another State. Such taxes are forbidden (see pages 7-8, *supra*) because their subject matter (the activity of severance or sale) and their measure (the "full value" of the severance or sale (*Tyler Pipe*, slip op. 18)) have an insufficient connection to any State except the State of severance or sale. Other States, however, plainly have a sufficient nexus with *portions* of the value of even a site-specific activity – notably, the portion that represents the income generated by the activity; otherwise, the unitary-business formula-apportionment method could not be applied to any item that had been subject to a severance or sales tax by another State. Thus, when a State denies a deduction in calculating a pre-apportionment company-wide figure as part of formula apportionment, the subject matter of the resulting tax is still some form of company-wide activity (net income or something else); and if the cost-producing activity is conducted by a unitary business, the State has a sufficient nexus with that subject matter. Moreover, the measure of the resulting tax could well be some figure that, given unitariness, fairly depends in part on the company's activities in the taxing State, as a severance or sales tax, under this Court's decisions, would not.[17]

[17] Contrary to appellants' suggestion (87-453 J.S. 21; 87-464 J.S. 16-17), therefore, the effect of New Jersey's deduction denial here is not identical to the effect that would be produced by the State's imposition of its own apportioned windfall profit tax. Such a tax, like a severance tax or the federal windfall profit tax itself, would be incurred on particular properties without any offset for losses on other properties. By contrast, where a deduction for a site-specific cost is denied in calculating unitary income, losses from the rest of the business are fully offset before any tax is imposed. Thus, while a producer can incur a federal windfall profit tax liability even though it has more than offsetting net losses company-wide for a particular tax year, there would be no New Jersey "entire net income" in such a situation. The tax effect of a deduction denial like New Jersey's does not turn exclusively on a specific out-of-State activity but depends also on the other activities of the unitary business in New Jersey and elsewhere in the tax year.

Accordingly, when a State denies a deduction for a particular cost, we doubt that a constitutional problem (a nexus or fair-relationship problem) results simply by virtue of the fact that the cost is incurred out-of-State. A problem may arise, however, when a State denies a deduction for a cost that is incurred so disproportionately out-of-State (*e.g.*, exclusively) that the constitutional principles of fair apportionment and nondiscrimination,[18] which require comparison of in-State and out-of-State events, are implicated. It is the skewing of a unitary-business apportioned income tax that may present a difficulty. Skewing of this sort was presented in *Westinghouse Electric Corp.*, where a State granted a credit, in its apportionment formula, that depended on whether certain activities took place in the State or elsewhere. That case, unlike these, involved a traditional Commerce Clause bar on a facial discrimination that encouraged the transfer of a business activity into the taxing State, but an analogous problem may arise at least when a taxpayer is not permitted to deduct a cost that can be incurred only out-of-State (lesser disparities not being squarely at issue in these cases).

The heart of the problem is this: although, by assumption, the State could not hope to encourage the transfer of the cost-producing activity into the State, it would nonetheless be granting to those conducting activities in the State a reduced-fare (if not a free) ride for the benefits of state government -- just as surely as if it had required a doubling of revenues received out-of-State. That is the core of appellants' claim, but we note that the practice might at least theoretically also have certain secondary consequences that this Court has discussed (though these may not be of *independent* legal significance). It could create an incentive to shift resources away from the out-of-State cost-producing activity (*e.g.*, oil production) and into an activity that did not incur the special tax burden – perhaps an in-State activity (*e.g.*, refining, marketing, chemical manufacture). See 87-453 J.S. 20 (the greater the out-of-State activity, the greater the tax effect); *Maryland* v. *Louisiana*, 451 U.S. at 757 (tax credit unconstitutionally encourages investment in in-State mineral exploration and development rather than out-of-State gas production). Efficiency-based business decision-making could be distorted. See *Westinghouse Electric Corp.*, 466 U.S. at 406. And if States generally began to exploit out-of-State activities in this manner, with different States denying deductions for different costs, there could result a substantial impairment of free trade. See 87-453 J.S. 26.

[18] See *Armco Inc.*, 467 U.S. at 644 ("A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce.").

For these reasons, it seems to us incorrect to argue, as appellee appears to do (87-453 Mot. to Aff. 14-15, 17-18; 87-464 Mot. to Aff. 4), or to conclude, as the New Jersey Supreme Court appears to have done (J.S. App. 33a-34a), that there can be no constitutional problem as long as a State is merely denying deductions and does not tax more than gross receipts. Geographic skewing of deductions may present a constitutional difficulty even if no taxpayer is taxed on more than gross receipts.

b. Before determining that a State deduction denial is invalid because of its geographic skewing, caution is clearly in order. The Court has long recognized that States have broad leeway to define their taxing systems generally and to depart from federal definitions of income in particular. See *Northwestern Cement*, 358 U.S. at 457; *Nashville, C. & St. L. Ry.* v. *Browning*, 310 U.S. 362, 365 (1940); *Bass, Ratcliff*, 266 U.S. at 283; *Shaffer* v. *Carter*, 252 U.S. 37, 51 (1920). It has held that various apportionment methods are permissible despite their inherent imprecision and the potential for duplicative taxation created by different States' use of different methods. See, *e.g.*, *Container Corp.*, 463 U.S. at 171; *Mobil Oil Corp.*, 445 U.S. at 448; *Moorman Mfg.*, 437 U.S. at 274.[19] It also has stated that there is no single correct way to define net income and that the

[19] As we have noted, in none of the decisions in which this Court has declared acceptable the imprecisions of formula-apportionment methods of taxing unitary businesses was there a claim like appellants' of geographically skewed treatment of different sources of income. Such treatment could greatly magnify such imprecisions. It may be that the absence of pronounced skewing is a necessary premise of the acceptability of formula-apportionment methods.

Constitution does not require a uniform definition. See *Moorman Mfg.*, 437 U.S. at 278-279 (some multiple taxation for unitary businesses is permitted because, inter alia, the Court would otherwise have to set uniform rules for state taxes, including rules for the definition of pre-apportionment income). And it has set a high standard for a concededly unitary business to sustain an attack on a State's tax as unfairly apportioned, requiring that the taxpayer show that the apportioned share is "out of all appropriate proportion" to the share of business "actually" conducted in the State (see *Container Corp.*, 463 U.S. at 175; *Moorman Mfg.*, 437 U.S. at 274).

In addition, as appellee suggests (87-453 Mot. to Aff. 15), there are important practical reasons for caution about challenges to States' disallowance of deductions for particular costs. States have various methods of calculating pre-apportionment income.[20] Some "singled out" deductions doubtless have differential out-of-State effects on particular taxpayers, on groups of taxpayers, or on all taxpayers to whom they apply. Some deductions are almost by definition industry-specific—*e.g.*, for oil depletion or intangible drilling costs. Thus, appellants' challenge based on the geographical bias of the windfall profit tax element of the "entire net income" definition presents the prospect of other challenges to other elements of the pre-apportionment income definition by appellants and by other taxpayers with costs or income sources that are site-specific and located exclusively out-of-State. And since what activities take place in a State may change over time, the argument put forth by appellants might require, as a matter of constitutional law, corresponding changes in the State's tax laws.

[20] According to one commentator (1 J. Hellerstein, *State Taxation* (1983)), States deviate in a variety of ways from the use of federal taxable income as a measure of apportionable income—by, for example, declining to gr[illegible] preferential treatment to long-term capital gains (¶ 7.6), superimposing their own depreciation and depletion allowances (¶ 7.7), disallowing the carryover or carryback of deductions for net operating losses (¶ 7.3), denying a foreign tax credit (¶ 7.9), or denying the federal "dividends received" deduction (¶ 7.5) or deductions for expenses attributable to income not taxed by the State (¶ 7.8) or for foreign taxes paid (¶ 7.9) or for state and local taxes measured by net income (¶ 7.10).

The above reasons for caution warrant full consideration at the merits stage of these cases, with particular attention to the practical implications of recognizing the validity of appellants' claim. Practicalities have often played a role in the Court's definition of constitutional standards (*e.g.*, *Container Corp.*, 463 U.S. at 185-186; *Moorman Mfg.*, 437 U.S. at 278-279). And it may be that the reasons for caution we have sketched present insurmountable objections to appellants' claim. It is important to note, however, that the challenge we consider substantial here is narrowed by several inherent limitations.[21]

First, the challenge applies only to costs that are properly identified as site-specific, those whose amount increases directly with the level of activity that is identifiably out-of-State. We doubt, for example, that interest payments on an integrated company's debts should be considered site-specific. On the other hand, under this Court's decisions, a severance tax would seem intrinsically site-specific.

[21] These cases involve only a problem of geographic skewing. It light of appellee's broad suggestion that a State may freely tax any amount up to gross receipts, we note that there may also be other limits, not involved here, on a State's disallowance of deductions in a unitary-business formula-apportionment tax. Notably, as more and more costs are disallowed, the pre-apportionment figure moves away from "net income" and toward gross revenues. Yet, while this Court has suggested that some gross receipts taxes may be imposed by "apportionment" methods such as mileage ratios for multistate transportation companies (see, *e.g.*, *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. 653, 663 (1948); *Gwin, White & Prince*, 305 U.S. at 439), it has not generally considered whether a State may tax a unitary business's gross receipts by multiplying company-wide receipts by ratios like that used by New Jersey (payroll, receipts, property). Cf. *Armco Steel Corp.* v. *Michigan*, 359 Mich. 430, 102 N.W.2d 552, appeal dismissed, 364 U.S. 337 (1960) (apportioned tax on "adjusted receipts," permitting deduction for many costs but not for payroll and depreciation).

Any such tax would create a risk [illegible] tiple taxation, because the in-State receipts are fully taxable by the State [illegible] y are received (*e.g.*, *Tyler Pipe*, slip op. 18). And although it might be argued that the actual in-State receipts are not the best measure of the State's contribution to company-wide receipts, the practical justification for using an apportionment formula is considerably weaker for gross receipts than for income. That justification rests to a large degree on the difficulty of identifying the State in which *profits* (the net of revenues over costs) are generated (*Container Corp.*, 463 U.S. at 164, 166);

Second, contrary to the apparent suggestion of appellants Texaco and Tenneco (87-464 J.S. 9-17), even for an out-of-State cost, no complaint is justified simply because the State denies a deduction for the cost. Rather, the challenge depends on an in-State/out-of-State comparison of the incidence of that cost, so that if the State treats comparable in-State costs in the same manner, there may be no constitutional problem. For example, a State where significant oil production occurs could deny deductions for specified oil production costs; and a non-copper-producing State might permissibly deny a deduction for other States' copper severance taxes if it denied a deduction for *all* severance taxes and it had, for example, substantial coal severance activity and its own coal severance tax. In short, it should remain open to a State to defend a deduction denial by showing that it is comparable to other deduction denials for costs that are incurred in-State.[22]

Third, these cases involve a cost that is incurred exclusively out-of-State, so the Court need not rule on cases involving less stark skewing. Because some exploration of the limits of appellants' challenge would be necessary on plenary review, however, we note that there would be a firm basis in this Court's decisions for limiting the challenge to cases that involve geographic skewing that is pronounced and systemic, and not limited to particular taxpayers based on the fortuity of the locations of parts of their businesses. This standard would be met at

but receipts are one of the standard elements of the three-factor apportionment fraction precisely because their location is objectively measurable with reasonable certainty.

[22] It may be possible for even a gross geographic skewing of a state tax measure to be justified on other grounds, perhaps as needed to serve certain regulatory objectives. *Exxon Corp.* v. *Maryland, supra,* on which appellee relies (87-453 Mot. to Aff. 21-22), may provide an illustration. There, the State imposed a burden on integrated oil companies on account of their exclusively out-of-State activities (oil production), but it did so because it determined that the out-of-State activity was having a harmful effect on an in-State activity (retailing). Of course, that case involved a regulatory measure, not a tax measure, and New Jersey has advanced no regulatory objectives in these cases.

least where skewing of significant magnitude is obvious as soon as the deduction being disallowed is described, as it is when a non-producing State disallows a deduction for a substantial cost incurred only in oil production.[23] This requirement is consistent with the Commerce Clause's concern with protecting interstate commerce, not particular businesses (*Exxon Corp.* v. *Maryland,* 437 U.S. at 127-128), with this Court's frequent warnings that some imperfections must be tolerated, and with the Court's focus on practicalities in defining constitutional standards in this area (*e.g., Container Corp.,* 463 U.S. at 185-193; *Moorman Mfg.,* 437 U.S. at 278-279). Practicalities would obviously be highly relevant in seeking to delimit whatever class of cases to which appellants' challenge may apply.

c. For the reasons we have explained, *if* windfall profit tax liability is a site-specific cost not comparable to an in-State cost, there is present in these cases a substantial, constitutionally problematic geographic skewing (the free-rider problem) of the New Jersey corporate income tax base.[24] The remaining questions are whether the windfall profit tax paid to the United

[23] These cases do not present any but the starkest geographic skewing. New Jersey has no oil production. (Similarly, six of the other seven States that have denied a deduction for the windfall profit tax have either no oil production or a de minimis amount.) 87-453 J.S. 14-15. Appellants characterize the impact here as falling on a "discrete group of substantial taxpayers" (*id.* at 18), and they note that the impact is itself appreciable (*id.* at 13-14; see note 16, *supra*). They stress that New Jersey's tax is "*structurally* defective, so that it necessarily distorts the net income base of every integrated oil company" (87-453 Br. in Opp. 5 (emphasis added)).

[24] In addition to the fact that New Jersey has no oil production at all, the deduction denial effects an appreciable increase in New Jersey liability both in dollar amounts (see notes 16, 23, *supra*) and in percentages (see J.S. App. 84a (table)). We note that, because the tax liability is calculated by multiplying "entire net income" by the apportionment fraction by the tax rate, the same percentage increases in tax liability could have been achieved by leaving the "entire net income" base unchanged but increasing the apportionment fraction by the same percentages. For example, the deduction disallowance for Atlantic Richfield in 1981 caused a 174% increase in tax liability (*ibid.*); this is the equivalent of a 174% increase in its apportionment fraction of 1.0995% (Pltf. Jt. App. 757a, 783a) to more than 3%. And for Gulf in 1981, to obtain the

States is a site-specific cost and, if so, whether its deduction may nonetheless be disallowed because it is sufficiently like another in-State outlay whose deduction is also disallowed by the State. The first question does not seem difficult: the windfall profit tax is site-specific in the critical respect – liability for it is as directly related to activity that takes place at a geographically identifiable place as is liability for an ordinary severance tax. The second question is more difficult, though it may be substantially narrowed. Because the only non-deductible outlay that is (or could be) alleged to be comparable is federal income tax liability,[25] this question calls for an inquiry into whether the windfall profit tax is more like an ordinary severance tax, whose subtraction New Jersey allows in calculating the "entire net income" tax base, than it is like the federal income tax, whose subtraction New Jersey does not allow.[26]

In examining that seemingly determinative question, it seems to us that full briefing and argument is needed. We have not ourselves come to a conclusion on the question. We note here simply that most of the relevant considerations seem to point toward appellants' resolution – that windfall profit taxes are a

same increase in tax liability, the apportionment fraction would have to be increased more than 11-fold from 1.3564% (Pltf. Jt. App. 946a, 974a) to more than 16%.

[25] Of course, the reason deduction of the windfall profit tax is disallowed is that the New Jersey Supreme Court found it to be a tax, like the federal income tax, that is "measured by profits or income" (N.J. Stat. Ann. § 54:10A-4(k)(2)(C) (West 1986)). The court did not justify the State's treatment of the windfall profit tax based on any assertedly offsetting unrelated special advantages afforded oil producers by federal or state tax laws. On the subject of offsetting-benefit justifications, see, *e.g.*, *American Trucking Ass'ns*, slip op. 20-21; *Tyler Pipe*, slip op. 14-15; *Travis* v. *Yale & Towne Mfg.*, 252 U.S. at 81.

[26] New Jersey denies all taxpayers a deduction for federal income taxes, and that plainly has no overall disparate geographic effect. By contrast, New Jersey ordinarily allows subtraction of severance taxes, because such taxes would be deductible business expenses or costs of goods sold in calculating the federal taxable income on which New Jersey bases its tax. See 26 C.F.R. 1.164-3(f); 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 32.2.3, at 32-17 to 32-18 (1981).

site-specific cost like ordinary severance taxes and unlike federal income taxes. But cf. *Tenneco West, Inc.* v. *Marathon Oil Co.*, 756 F.2d 769 (9th Cir.), cert. denied, 474 U.S. 845 (1985) (contract interpretation).

We begin with the formal operation of the tax measures to be compared. The federal corporate income tax, like the personal income tax, is imposed on persons for their overall annual activities. By contrast, the incidence of the windfall profit tax is on a specified activity or transaction, which takes place at a particular time and at a particular place: a tax is owed "upon the removal of taxable crude oil" (H.R. Conf. Rep. 96-817, 96th Cong., 2d Sess. 106 (1980)). Moreover, whereas the measure of the federal income tax is based on the taxpayer's company-wide and overall bottom line, the measure of the windfall profit tax is a figure tied to the particular producing property (in a particular State) at the time of removal. Hence, there is a direct relation between the oil production activity at that time and place and windfall profit tax liability, as with an ordinary severance tax; and losses from other properties or other business activities are not offset, as they are for the income tax.

Further, even with the per-barrel "net income" limitation, the measure of the windfall profit tax generally depends on value at the property and not, like the income tax, on actual revenues: for oil transferred within an integrated company, the "uncontrolled" price used to calculate the tax base is the "posted" price at the producing property at the time of removal (see I.R.C. §§ 613, 4986, 4988; 26 C.F.R. 1.613-3(a)).[27] And that is so, apparently, without regard to whether the particular oil ends up producing less revenue because of future events such as casualty losses or a decline in prices between removal and sale at the pump.[28] Thus, the New Jersey Supreme Court, citing evidence

[27] The applicable regulation states, in pertinent part: "[T]he gross income from the property shall be assumed to be equivalent to the representative market or field price of the oil or gas before conversion or transportation." 25 Fed. Reg. 11804 (1960); see 26 C.F.R. 1.613-3(a).

[28] There are two ways in which a producer can earn less net income from a barrel than the general "windfall profit" – *i.e.*, "removal price" minus "adjusted base price." One is for the producer to earn less revenue than the ex-

submitted by the State, stated (J.S. App. 29a) that "[t]he posted price fixes the value of the oil at the point of lifting. Later events do not detract from this fact." See also Pltf. Jt. App. 1142a (stipulation) (appellants did not receive windfall profit tax refunds or credits for oil lost after removal). The federal income tax, of course, depends on actual revenues and on activities throughout a company throughout the year.

Congress's understanding generally supports the conclusion that the windfall profit tax is closer to an ordinary severance tax than to the income tax.[29] First, although statutory labels are not conclusive (*Complete Auto*, 430 U.S. at 279, 281), the windfall profit tax was proposed, enacted, and understood by Congress as an "excise" or "severance" tax. See I.R.C. § 4986; 15 Weekly Comp. Pres. Doc. at 723; H.R. Conf. Rep. 96-817, *supra*, at 92; H.R. Rep. 96-304, *supra*, at 2; S. Rep. 96-394, *supra*, at 2, 29, 154. Consistent with that understanding, Congress, in estimating the expected revenues from the windfall profit tax, expressly assumed that the tax would be deductible for state income tax purposes. H.R. Conf. Rep. 96-817, *supra*, at 163; H.R. Rep. 96-304, *supra*, at 9; S. Rep. 96-394, *supra*, at 9. Further, Congress had imposed excess profits taxes during World

pected revenue that was assumed when the posted field price at removal was set—because, for example, of losses or price drops. The other is for the producer to incur higher costs than the "adjusted base price" reflects. Congress mentioned only the latter problem in explaining the "net income limitation." S. Rep. 96-394, *supra*, at 29; H.R. Rep. 96-304, *supra*, at 2.

Indeed, Congress not only did not provide for adjustments in the event of post-removal changes in revenue, but it adopted the excise tax mechanism, for enforcement-simplification purposes, specifically to eliminate the need to look past the single event of removal. H.R. Rep. 96-304, *supra*, at 43; S. Rep. 96-394, *supra*, at 66. Both congressional committees stated, "only one event determines the windfall profit tax liability—the first sale" (which is deemed to be removal, where no on-site sale occurs). H.R. Rep. 96-304, *supra*, at 43; S. Rep. 96-394, *supra*, at 66. Congress also gave the Secretary of the Treasury the authority to ensure that, notwithstanding the sale price, "parties use a removal price which clearly reflects the fair market value of the oil" (S. Rep. 96-394, *supra*, at 67). See H.R. Conf. Rep. 96-817, *supra*, at 105.

[29] Even if the evidence of Congress's understanding is not sufficient for a preemption argument, it is relevant to determining the character of the windfall profit tax.

War II and the Korean War; and those taxes, like the income tax itself, were imposed on company-wide bottom-line income.[30] Yet the 1980 Congress that enacted the windfall profit tax, while specifically noting those precedents, departed from them for the "far simpler approach" of "an excise tax" (H.R. Rep. 96-304, *supra*, at 7). Thus, although Congress's motivation was to tax what it determined to be expected windfall profits, the evidence shows that it chose to accomplish that end by what it understood to be a transaction- or activity-based tax akin to a severance tax.

Against these considerations, the principal argument in favor of finding similarity to the income tax is the argument implicit in the New Jersey Supreme Court's view, expressed in construing the add-back provision (J.S. App. 16a-29a), that the windfall profit tax is imposed on some portion of revenues that is net of real economic costs.[31] In this view, New Jersey is simply ignoring the federal government's two-part separation of what is all real net income of oil producers. If the federal government or any State imposed any other taxes that worked in the same way, the argument would run, New Jersey would treat them in the same fashion; and in any event, New Jersey has broad freedom to determine for itself that this reasonable way is the proper way of viewing the windfall profit tax.

It may be that this argument, in light of the leeway permitted States under the Constitution, should lead ultimately to rejection of appellants' contention. We note, however, that there are

[30] Excess Profits Tax Act of 1950, ch. 1199, 64 Stat. 1137; Revenue Act of 1942, ch. 619, §§ 201-230, 56 Stat. 899-936; Second Revenue Act of 1940, ch. 757, § 201, 54 Stat. 975-998; see H.R. Conf. Rep. 3002, 76th Cong., 3d Sess. 42-48 (1940); H.R. Rep. 2333, 77th Cong., 2d Sess. 18-19 (1942); H.R. Rep. 3142, 81st Cong., 2d Sess. 1-4 (1950); see also Revenue Act of 1917, ch. 159, 39 Stat. 1000.

[31] It does not advance the inquiry to suggest that New Jersey is simply taxing the full amount it would have taxed if the United States had not imposed a windfall profit tax, and instead taxed profits only through the corporate income tax, or that New Jersey is simply taxing in one stage what the federal government taxes in two. The same suggestions could be made for any new federal severance tax; and the first suggestion could be made for any new "real" cost of business.

difficulties with this argument. First, there are practical and theoretical problems with trying to determine which of the various amounts a company must pay out to others (including governments) constitutes a "real" economic cost. Second, even if the proposed distinction between costs of earning income and payments out of income earned were sound, the windfall profit tax would appear to fall into the former category. As we have noted, and as the New Jersey court itself pointed out based on submissions by appellee (J.S. App. 29a), the windfall profit tax is incurred (and, as far as the statute and regulations suggest, measured) without regard to the eventual receipt of income for particular oil after its refining and marketing. Third, it is not clear that the argument, even if it were workable and it applied here, would be a sufficient answer to the considerations adduced above, because a tax that is imposed even on only a portion of the value of a site-specific activity remains, like an ordinary severance tax, directly related to the level of activity at that site, and not to company-wide activities. Finally, the fact that all taxpayers are taxed only on "real" net income does not necessarily cure all constitutionally problematic geographic skewing: such skewing would be present, for example, if New Jersey allowed a deduction for one-half of "real" net income to all taxpayers except those who engage in oil production.

In sum, appellants have a substantial argument that the windfall profit tax is a site-specific cost of business comparable to an ordinary severance tax. Because New Jersey excludes other severance taxes from its corporate income tax base, and because the windfall profit tax is incurred only for out-of-State activities, appellants have a substantial constitutional claim.

CONCLUSION

For the foregoing reasons, probable jurisdiction should be noted.

Respectfully submitted.

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Nos. 87-453 and 87-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

AMERADA HESS CORPORATION *et al.*,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeals from the Supreme Court of New Jersey

JOINT APPENDIX

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The following items have been omitted in printing this Joint Appendix because they appear on the following pages in the Appendix to the Jurisdictional Statement in No. 87-453:

RELEVANT DOCKET ENTRIES

TAX COURT OF NEW JERSEY

A. ***Parties:***

Name	*Docket No.*
Diamond Shamrock Corporation *	CB 065B-83
Shell Oil Company *	CB 066B-83
Cities Service Company *	CB 067B-83
Exxon Corporation *	CB 068B-83
Atlantic Richfield Company	CB 069B-83
Union Oil Company of California *	CB 070B-83
Mobil Oil Corporation *	CB 071B-83
Phillips Petroleum Company *	CB 072B-83
Gulf Oil Corporation *	CB 073B-83
Chevron U.S.A. Inc.*	CB 074B-83
Conoco Inc.*	CB 075B-83
Amerada Hess Corporation	CB 064B-83
Texaco Inc.	CB 077B-83
Tenneco Oil Company	CB 128B-83

B. ***Relevant Docket Entries:***

Description	*Date*
1. Complaints Filed:	
Diamond Plaintiffs	May 6, 1983
Amerada Hess	May 6, 1983
Texaco	May 6, 1983
Tenneco	Oct. 7, 1983

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* The New Jersey actions and appeals of these plaintiff corporations were not consolidated (other than for briefing and argument purposes) because of practical difficulties arising from protective orders entered in each of the actions. These plaintiff corporations, however, shared common counsel, and in most instances pleadings and other papers were filed on behalf of each either simultaneously or in a joint filing. Accordingly, for ease of reference, these plaintiff corporations will be referred to collectively as the "Diamond Plaintiffs."

Description	Date
2. Amended Complaints Filed:	
Cities Service	June 27, 1983 and Dec. 14, 1983
Shell	Dec. 14, 1983
Gulf	Dec. 14, 1983
Diamond Shamrock	Dec. 22, 1983
3. Answers Filed:	
Diamond Plaintiffs	July 5, 1983
Amerada Hess	July 5, 1983
Texaco	July 5, 1983
Tenneco	Oct. 27, 1983
4. Answers to Amended Complaints Filed: *	
Shell	Dec. 19, 1983
Diamond Shamrock	Jan. 3, 1984
Cities Service	July 5, 1983 and Dec. 19, 1983
5. Motion for Summary Judgment and Supporting Memorandum (Amerada Hess) Filed:	March 16, 1984
6. Stipulation of Facts Entered and Filed (Diamond Plaintiffs):	May 11, 1984
7. Supplementary Stipulation of Facts Entered and Filed (Diamond Plaintiffs):	May 11, 1984

* No answer was required to be filed to the amended complaint of Gulf pursuant to the Pretrial Order entered in that action.

Description	Date
8. Notice of Motions for Summary Judgment and Supporting Joint Brief and Appendix (Diamond Plaintiffs) Filed:	May 11, 1984
9. Notice of Motions for Summary Judgment and Supporting Memorandum (Texaco and Tenneco) Filed:	May 11, 1984
10. Notice of Cross-Motions for Summary Judgment and Motion for Consolidation with Supporting Affidavits and Memorandum (Defendant) Filed:	June 8, 1984
11. Joint Brief and Appendix of Defendant in Opposition to Plaintiffs' Motions for Summary Judgment and in Support of Defendant's Cross-Motions for Summary Judgment Filed:	June 8, 1984
12. Reply Briefs Filed:	
Diamond Plaintiffs	June 22, 1984
Amerada Hess	June 22, 1984
Texaco	June 22, 1984
Tenneco	June 22, 1984
13. Joint Reply Brief of Defendant Filed:	June 28, 1984
14. Oral Argument before Hon. Richard M. Conley, J.T.C., Held:	June 29, 1984

Description	Date
15. Opinion of N.J. Tax Court on Motions and Cross-Motions for Summary Judgment:	Sept. 28, 1984
16. Judgments Entered:	
Diamond Plaintiffs	Oct. 5, 1984
Amerada Hess	Oct. 5, 1984
Texaco	Oct. 5, 1984
Tenneco	Oct. 5, 1984
17. Corrected Judgments Entered:	
Shell	Oct. 16, 1984
Cities Service	Oct. 16, 1984
Gulf	Oct. 16, 1984
Amerada Hess	Oct. 16, 1984
Atlantic Richfield	Oct. 16, 1984 and Feb. 21, 1985
Conoco	Feb. 21, 1985
18. Notices of Motion for Reconsideration and Supporting Briefs Filed:	
Diamond Plaintiffs	Oct. 22, 1984
Amerada Hess	Oct. 23, 1984
Texaco	Oct. 24, 1984
Tenneco	Oct. 24, 1984
19. Brief of Defendant in Opposition to Motions for Reconsideration Filed:	Nov. 7, 1984
20. Oral Argument before Hon. Anthony M. Lario, J.T.C., Held:	Nov. 16, 1984
21. Opinion of N.J. Tax Court on Motions for Reconsideration:	Feb. 14, 1985

SUPERIOR COURT OF NEW JERSEY, APPELLATE DIVISION

A. *Parties*:

Name	*Docket No.*
Atlantic Richfield	A-02795-84T7
Conoco	A-02796-84T7
Cities Service	A-02797-84T7
Exxon	A-02799-84T7
Tenneco	A-02800-84T7
Phillips	A-02809-84T7
Chevron	A-02812-84T7
Union	A-02814-84T7
Gulf	A-02816-84T7
Shell	A-02818-84T7
Diamond Shamrock	A-02819-84T7
Texaco	A-02832-84T7
Amerada Hess	A-02846-84T7

B. *Relevant Docket Entries*:

Description	*Date*
1. Notices of Appeal Filed:	
Diamond Plaintiffs	Feb. 28, 1985
Texaco	March 1, 1985
Tenneco	March 1, 1985
Amerada Hess	March 6, 1985
2. Order Granting Motion to Consolidate Appeals for Argument:	April 8, 1985
3. Joint Brief and Appendix of Diamond Plaintiffs Filed:	May 20, 1985
4. Joint Brief and Appendix of Texaco and Tenneco Filed:	May 20, 1985

Description	Date
5. Brief and Appendix of Amerada Hess Filed:	May 20, 1985
6. Joint Answering Brief and Appendix of Defendant Filed:	Sept. 13, 1985
7. Joint Reply Brief of Diamond Plaintiffs Filed:	Sept. 19, 1985
8. Joint Reply Brief of Texaco and Tenneco Filed:	Sept. 19, 1985
9. Reply Brief of Amerada Hess Filed:	Sept. 19, 1985
10. Oral Argument before the Superior Court of New Jersey, Appellate Division, in Consolidated Appeals Held:	Jan. 7, 1986
11. Opinion of the Superior Court of New Jersey, Appellate Division (Reversing New Jersey Tax Court):	Feb. 7, 1986

SUPREME COURT OF NEW JERSEY

A. ***Parties:***

Name	Docket No.
Amerada Hess	25,264
Texaco	25,265
Tenneco	25,266
Diamond Shamrock	25,267
Shell	25,268
Gulf	25,269
Union	25,270

Name	Docket No.
Mobil	25,271
Chevron	25,272
Phillips	25,273
Exxon	25,274
Cities Service	25,275
Conoco	25,276
Atlantic Richfield	25,277

B. ***Relevant Docket Entries:***

Description	Date
1. Notices of Petition of Defendant for Certification Filed:	Feb. 27, 1986
2. Joint Petition of Defendant for Certification and Appendix (together with copies of Joint Appellate Division Briefs and Appendix) Filed:	March 10, 1986
3. Joint Brief of Diamond Plaintiffs in Opposition to Petition for Certification (together with copies of Joint Appellate Division Briefs and Appendix) Filed:	March 25, 1986
4. Joint Brief of Texaco and Tenneco in Opposition to Petition for Certification (together with copies of Joint Appellate Division Briefs and Appendix) Filed:	March 27, 1986
5. Brief of Amerada Hess in Opposition to Petition for Certification (together with copies of Appellate Division Briefs and Appendix) Filed:	March 27, 1986

Description	Date
6. Order Granting Petition for Certification Entered:	June 5, 1986
7. Supplemental Letter of Defendant, Enclosing and Discussing Recent Opinion, Filed:	June 13, 1986
8. Letter Responses of Diamond Plaintiffs and Amerada Hess to Supplemental Letter of Defendant Filed:	June 23, 1986
9. Joint Letter Response of Texaco and Tenneco to Supplemental Letter of Defendant Filed:	June 24, 1986
10. Argument before Supreme Court of New Jersey in Consolidated Appeals:	Nov. 18, 1986
11. Opinion and Judgment of Supreme Court of New Jersey in Consolidated Appeals:	June 22, 1987
12. Notices of Appeal to Supreme Court of the United States Filed:	
Diamond Plaintiffs	Aug. 20, 1987
Amerada Hess	Aug. 20, 1987
Texaco	Aug. 21, 1987
Tenneco	Aug. 21, 1987

TAX COURT OF NEW JERSEY

Docket Nos.

CB 065B-83 CB 072B-83
CB 066B-83 CB 073B-83
CB 067B-83 CB 074B-83
CB 068B-83 CB 075B-83
CB 069B-83
CB 070B-83
CB 071B-83

Civil Actions

DIAMOND SHAMROCK CORPORATION,
SHELL OIL COMPANY,
CITIES SERVICE COMPANY,
EXXON CORPORATION,
ATLANTIC RICHFIELD COMPANY,
UNION OIL COMPANY OF CALIFORNIA,
MOBIL OIL CORPORATION,
PHILLIPS PETROLEUM COMPANY,
GULF OIL CORPORATION,
CHEVRON U.S.A., INC.,
and CONOCO INC.,

Plaintiffs,

—vs—

DIRECTOR, DIVISION OF TAXATION,

Defendant.

STIPULATION OF FACTS

Pursuant to paragraph 10 of each of the Pretrial Orders entered in these actions, and subject to the right of any party hereto (i) to contest the evidentiary issues

of relevancy and materiality and (ii) to supplement this Stipulation by other evidence not inconsistent herewith,

IT IS HEREBY STIPULATED AND AGREED that, for the purposes of these actions, the following statements may be accepted as facts and all exhibits referred to herein and attached hereto are incorporated into this Stipulation and made a part hereof:

DEFINITIONS.

1. As used herein:

(a) "Adjusted Base Price" shall mean and refer to "adjusted base price", as defined in I.R.C. § 4989(a).

(b) "CBT Act" shall mean and refer to the New Jersey Corporation Business Tax Act, as amended, N.J.S.A. 54:10A-1 *et seq.*

(c) "Director" shall mean and refer to the Director of the Division of Taxation, New Jersey Department of the Treasury, the defendant in each of these actions.

(d) "Entire Net Income" shall mean and refer to "entire net income", as defined in and computed in accordance with N.J.S.A. 54:10A-4(k).

(e) "FTI" shall mean and refer to the taxable income, before net operating loss deduction and special deductions, which each Plaintiff reported to the United States Treasury Department on U.S. Form 1120 for the purpose of computing its Federal income tax during the period at issue.

(f) "I.R.C." shall mean and refer to the Internal Revenue Code of 1954, as amended.

(g) "NIL" shall mean and refer to the "net income limitation", as defined in I.R.C. § 4988(b).

(h) "Period at issue" shall mean and refer to the tax years at issue in each of these actions, as specified in

paragraph 2 of each of the Pretrial Orders entered herein.

(i) "Plaintiffs" shall mean and refer, collectively, to Diamond Shamrock Chemicals Company (formerly "Diamond Shamrock Corporation"), Union Oil Company of California, Shell Oil Company, Phillips Petroleum Company, Mobil Oil Corporation, Gulf Oil Corporation, Exxon Corporation, Conoco Inc., CanadianOxy Offshore Production Co. (formerly, "Cities Service Company"), Chevron U.S.A. Inc. and Atlantic Richfield Company.

(j) "Taxable Crude Oil" shall mean and refer to "taxable crude oil", as defined in I.R.C. § 4991(a).

(k) "WPT Act" shall mean and refer to the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223, 94 Stat. 229 (1980), the tax provisions of which are codified in I.R.C. §§ 4986-4998.

(l) "WPT" shall mean and refer to the tax imposed under the WPT Act.

PARTIES PLAINTIFF.

2. During the period at issue each of the Plaintiffs was a vertically integrated oil and gas company engaged in, among other activities, those ranging from the exploration for crude oil through the production, refining, transportation, distribution and marketing or sale of petroleum and petroleum products.

3. Nine of the Plaintiffs were also engaged in the chemical business during the period at issue, involving the purchase, refining, manufacture, transportation and marketing of chemical products, including petrochemicals derived from petroleum. Of the Plaintiffs so engaged, one Plaintiff was involved only in the transportation and marketing—not the manufacture—of such petrochemicals.

4. The Plaintiffs were during the period at issue and are presently authorized to transact business in most of

the States of the United States and in the District of Columbia, and many of the Plaintiffs transact business and own property in nearly every such State and jurisdiction.

5. Collectively, the Plaintiffs have oil-producing properties in the States of Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, Utah, Wyoming and West Virginia, and in Federal offshore waters.

6. During the period at issue the Plaintiffs, collectively, had oil-refining facilities in the States of Alaska, California, Colorado, Hawaii, Illinois, Kansas, Louisiana, Maryland, Minnesota, Mississippi, Montana, New Jersey, New Mexico, Ohio, Oklahoma, Oregon, Pennsylvania, Texas, Utah and Washington. Of the eleven Plaintiffs, four had oil-refining facilities in New Jersey during this period.

7. Plaintiff Diamond Shamrock Chemicals Company, formerly "Diamond Shamrock Corporation" ("Diamond"), is a corporation organized under the laws of the State of Delaware, having its principal office in Dallas, Texas. Diamond was authorized to transact business in New Jersey in 1936. Diamond's principal business in New Jersey is the manufacture and marketing of chemicals. Diamond has four plants, two sales offices and an administrative and research center in New Jersey.

8. Plaintiff Shell Oil Company ("Shell") is a corporation organized under the laws of the State of Delaware, having its principal office in Houston, Texas. Shell was authorized to transact business in New Jersey in 1949. Its principal business in New Jersey is the marketing of its products and the manufacture of polypropylene. Shell has a manufacturing plant and a terminal facility

in New Jersey, and also owns some 240 service stations in the State.

9. Plaintiff CanadianOxy Offshore Production Co., formerly "Cities Service Company" ("Cities"), is a corporation organized under the laws of the State of Delaware, having its principal office in Tulsa, Oklahoma. Cities was authorized to transact business in New Jersey in 1970. During the period at issue, its principal business in New Jersey consisted of the distribution, supply and marketing of refined petroleum products and the sale of molded plastic products. Cities had in New Jersey during that period two refined product terminals, a research and technology laboratory, a refined product supply and distribution office, a lubes and specialty products office, an inspection station, an Eastern regional office and a number of service stations.

10. Plaintiff Exxon Corporation ("Exxon") is a corporation organized under the laws of the State of New Jersey, having its principal office in New York City. Exxon was incorporated in New Jersey in 1882. Its principal business in New Jersey is the manufacture and marketing of petrochemicals and the refining and marketing of crude oil, natural gas and petroleum products. Exxon has in New Jersey two chemical plants, a refinery, a manufacturing plant, two chemical division sales offices, four chemical division corporate offices, two divisional offices, two corporate offices, an aircraft hangar and numerous gasoline stations.

11. Plaintiff Atlantic Richfield Company ("Atlantic") is a corporation organized under the laws of the Commonwealth of Pennsylvania, having its principal office in Los Angeles, California. Atlantic was authorized to transact business in New Jersey in 1927. Its principal business in New Jersey is the marketing of natural gas and petroleum products. Atlantic has numerous gasoline stations in New Jersey.

12. Plaintiff Union Oil Company of California ("Union") is a corporation organized under the laws of the State of California, having its principal office in Los Angeles, California. Union was authorized to transact business in New Jersey in 1946. Its principal business in New Jersey is the manufacture, transportation and marketing of chemicals and the operation of two auto/truck stops used primarily in the marketing of the corporation's petroleum products. In addition to the two auto/truck stops, Union also has four chemical facilities in the State.

13. Plaintiff Mobil Oil Corporation ("Mobil") is a corporation organized under the laws of the State of New York, having its principal office in New York City. Mobil was authorized to transact business in New Jersey in 1933. Its principal business in New Jersey is the refining and marketing of petroleum products and, to a lesser extent, the manufacture and marketing of chemicals and paints. Mobil has in New Jersey a refinery, a corporate office and some 423 gasoline stations.

14. Plaintiff Phillips Petroleum Company ("Phillips") is a corporation organized under the laws of the State of Delaware, having its principal office in Bartlesville, Oklahoma. Phillips was authorized to transact business in New Jersey in 1934. Its principal business in New Jersey is the marketing of petrochemicals and refined petroleum products. Phillips has a petrochemical division office and a terminal in New Jersey and also leases, but does not operate, several gasoline stations in the State.

15. Plaintiff Gulf Oil Corporation ("Gulf") is a corporation originally organized under the laws of the Commonwealth of Pennsylvania and since reorganized under the laws of the State of Delaware, having its principal office in Pittsburgh, Pennsylvania. Gulf was authorized to transact business in New Jersey in 1936. Its principal business in New Jersey is the transportation and marketing of petroleum and chemical products. Gulf has two

terminals and a marketing office in New Jersey, and owns various gasoline stations located throughout the State.

16. Plaintiff Chevron U.S.A. Inc. ("Chevron") is a corporation organized under the laws of the State of California, having its principal office in San Francisco, California. Chevron is a wholly-owned subsidiary of Standard Oil Company of California. Chevron was authorized to transact business in New Jersey in 1943. Its principal business in New Jersey is the refining of crude oil, the manufacture and marketing of petroleum products, and the manufacture and sale of petrochemical feedstocks. Chevron has a lube oil bulk plant in New Jersey and owns or leases (but does not operate) 77 retail outlets, including gasoline stations, located throughout the State. During the period at issue Chevron also had a refinery in New Jersey.

17. Plaintiff Conoco Inc. ("Conoco") is a corporation organized under the laws of the State of Delaware, having its principal office in Houston, Texas. Conoco was authorized to transact business in New Jersey in 1929. Its principal business in New Jersey is the marketing and transportation of fuel oil, petrochemicals and other petroleum products. Conoco has in New Jersey two sales offices, two transportation facilities, one antifreeze blending plant and nine refined product storage facilities.

CHALLENGED ASSESSMENTS.

18. Each of the Plaintiffs filed with the Director its New Jersey CBT Return(s) for the period at issue.

19. In computing Entire Net Income on Schedule A of those Returns, Plaintiffs included on line 28 their FTI. A copy of each Plaintiff's CBT Return(s) for the period at issue is on file with the Court, sealed pursuant to the terms of the Protective Orders entered in these cases. Those CBT Returns are hereby designated Con-

fidential Exhibits A-1 to A-11.* A copy of each Plaintiff's separate company *pro forma* Federal income tax return is attached hereto subject to the said Protective Orders and, pursuant thereto, the returns are sealed under separate cover as Confidential Exhibits B-1 to B-11.**

20. In determining FTI, Plaintiffs deducted, among other items, (a) cost depletion with respect to crude oil and with respect to other minerals to the extent that allowable cost depletion exceeded allowable percentage depletion, (b) intangible drilling costs, (c) State income and franchise taxes, (d) Federal excise taxes (exclusive of the WPT), (e) State severance and production taxes, and (f) the WPT.

21. In determining FTI, most of the Plaintiffs also deducted percentage depletion with respect to certain minerals other than crude oil, including regulated natural gas and natural gas sold under fixed contracts as permitted under I.R.C. §§ 613 and 613A(b)(1).

22. [Intentionally Deleted]

23. In determining the adjustments to FTI in computing Entire Net Income (lines 29-35 of Schedule A of the CBT Return), Plaintiffs added back the deductions claimed on their Federal returns for the CBT but did not add back the deductions therein claimed for Federal excise taxes, State income and franchise taxes (other than the CBT), State severance and production taxes, and the WPT.

24. The Director issued assessments to each of the Plaintiffs, assessing deficiencies in the CBT due for the period at issue or reducing refunds claimed by certain of the Plaintiffs in their CBT Returns for that period. Each of those assessments was based upon the determination by the Director that the WPT paid or accrued by the Plaintiffs during the period at issue fell within the category of taxes described in N.J.S.A. 54:10A-4(k)(2)(C).

25. Following the submission of protests by each of the Plaintiffs, a meeting between representatives of the Division of Taxation and the American Petroleum Institute, and conferences between representatives of the Division and each Plaintiff, the Director issued final determination letters to each Plaintiff, assessing additional CBT or in certain cases disallowing or reducing refund claims based upon the failure of the Plaintiffs to make adjustments to their respective FTI in respect of the WPT paid or accrued by each Plaintiff during the period at issue. Copies of the final determination letters of the Director are appended as exhibits to Plaintiffs' complaints herein.

26. The amount(s) at issue with respect to each Plaintiff is (are) set forth in paragraph 4 of the Pretrial Order entered herein in that Plaintiff's case.

EFFECT OF WPT ACT ON PLAINTIFFS.

Taxable Production of Plaintiffs.

27. Well over 50% of the barrels of taxable crude oil produced by the Plaintiffs during the period at issue were included in Tier 1, as defined in I.R.C. § 4991(c). Plaintiffs' taxable production in Tier 2, as defined in I.R.C. § 4991(d), ranged from approximately 4% to less than 20% of their total taxable crude oil production. Plaintiffs' taxable production in Tier 3, as defined in I.R.C. § 4991(e), ranged from less than 1% to approximately 26% of their total taxable production.

28. Included in Confidential Exhibits C-1 to C-11, annexed hereto, is the total number of barrels of crude

* A list of exhibits filed with this Stipulation or already on file with the Court is attached immediately following the text.

** The designation "Confidential Exhibit ——", as used herein, shall indicate that the exhibit is subject to the terms of the Protective Orders entered in these cases and, pursuant thereto, is submitted herewith under sealed separate cover.

oil produced during the period at issue by each Plaintiff from properties in which each such Plaintiff is considered a "producer" under I.R.C. § 4996 and the applicable Treasury Regulations thereunder. Also included therein is the number of barrels of taxable crude oil so produced by each Plaintiff during the period at issue within each of the three Tiers under the WPT Act.

29. All of the Plaintiffs maintain separate records reflecting (a) the number of barrels of domestic crude oil produced from properties in which they are considered "producers" under I.R.C. § 4996 and (b) the number of barrels of domestic crude oil acquired from third parties. Once their own crude oil production is commingled with barrels of crude oil acquired from third parties, however, the records of the Plaintiffs reflect only the total number of barrels of crude oil entering into their respective downstream operations. None of the Plaintiffs keep or maintain, as part of their normal business records, records reflecting the number of barrels, so commingled, which were produced exclusively by each Plaintiff.

30. Of the total barrels of taxable crude oil either produced by the Plaintiffs or acquired from third parties during the period at issue, the number of barrels exchanged with third parties ranged from a net of 0% to 84%. Of the eleven Plaintiffs, one Plaintiff exchanged a net of 0% and 4.8% of such barrels during the years 1980 and 1981, one Plaintiff exchanged approximately 10% of such barrels, eight Plaintiffs exchanged between 20% and 42% of such barrels, and one Plaintiff exchanged approximately 84% of such barrels during the period at issue. The Plaintiff which exchanged a net of 0% and 4.8% of such barrels, sold at the lease or wellhead approximately 53% of the barrels produced by it or acquired from third parties during the years 1980 and 1981.

31. Of the total barrels of taxable crude oil either produced by the Plaintiffs or acquired from third parties

during the period at issue, the number of barrels sold at the lease or wellhead to third parties ranged from 0% to 53%. Of the eleven Plaintiffs, one Plaintiff had no sales at the lease or wellhead during the period at issue, eight Plaintiffs sold between 2% and 10% of such barrels, one Plaintiff sold approximately 12% of such barrels, and one Plaintiff sold approximately 53% of such barrels at the lease or wellhead during that period. The Plaintiff which had no sales at the lease or wellhead, exchanged with third parties approximately 39% of the barrels so produced or acquired during that period.

32. During the period at issue, six of the Plaintiffs maintained records of barrels of taxable crude oil lost after "remov[al] from the premises" within the meaning of I.R.C. § 4986(a) and Treas. Reg. § 51.4996-1(d), or otherwise not accounted for as transfers to downstream operations, sales or other disposals following "remov[al] from the premises." Attached hereto as Confidential Exhibit D-1 is a schedule setting forth the number and percentages of barrels of taxable crude oil so lost or not otherwise accounted for by such Plaintiffs.* For the Plaintiffs referred to in this paragraph, the applicable percentages and number of barrels so lost or otherwise not accounted for ranged from 0% to .39% and from 8.39 barrels to 1,088,847 barrels. An additional Plaintiff, which does not maintain records of lost or otherwise unaccounted for barrels, has estimated that .2% of its taxable crude oil fell within this category during the period at issue. None of those Plaintiffs received any refund of or credit for the WPT paid or accrued with respect to such barrels of taxable crude oil.

Adjusted Base Prices.

33. Attached hereto as Exhibit I is a list showing the Inflation Adjustment Factor, computed and defined under

* These Plaintiffs are identified by number only in Confidential Exhibit D-1. Attached hereto as Confidential Exhibit D-2 is a schedule identifying each such Plaintiff by name and number.

I.R.C. §§ 4989(a)(2) and (b), applicable in each calendar quarter from the effective date of the WPT through the third quarter of 1983.

34. For the years 1980 and 1981 the average adjusted base prices applicable to barrels of taxable crude oil with respect to which Plaintiffs were considered "producers" under I.R.C. §§ 4996, computed by dividing the total number of barrels "produced" by each Plaintiff within each tier of taxable crude oil by the aggregate adjusted base values thereof, were as follows:

Tier	1980 Range	1981 Range
1	$13.40-$14.40 *	$14.39-$15.74 *
2	$14.40-$17.10 *	$15.78-$18.75 *
3	$14.92-$19.02	$17.13-$21.10

Net Income Limitation.

35. The number of barrels of taxable crude oil produced by each of the Plaintiffs during the period at issue (expressed as a percentage of each Plaintiff's total taxable production) with respect to which the "windfall profit" attributable thereto was reduced by operation of the NIL (i) during the year 1980 ranged from approximately 14% to 73%, and (ii) during the year 1981 for those Plaintiffs whose period at issue includes 1981 ranged from approximately 10% to 82%. These approximate percentages may be summarized as follows:

* These upper range, average adjusted base prices represent the maximum adjusted base prices calculated by one of the Plaintiffs herein. The precise manner in which those prices were calculated is set forth in Confidential Exhibit E attached hereto. All other Plaintiffs computed "average adjusted base prices" by using information derived from their respective Forms 6248 or by producing the information set forth in Temp. Reg. § 150.4997-2(c)(1).

Percentage of Barrels (No. of Plaintiffs)

1980		1981	
14%	(1)	10%	(1)
18%	(1)	20%	(1)
22.5%-24%	(4)	45%	(1)
36%	(1)	82%	(1)
53.5%-57.5%	(2)		
71.5%-73.5%	(2)		

36. The extent to which the WPT liability of each of the Plaintiffs was reduced during the year 1980 by operation of the NIL (expressed as a percentage of the gross WPT liability of each Plaintiff), ranged from 21% to 44%. During the year 1981, the applicable percentage reductions for those Plaintiffs whose period at issue includes 1981 ranged from 3% to 13%. These approximate percentage reductions may be summarized as follows:

Percentage Reductions (No. of Plaintiffs)

1980		1981	
21%-30%	(8)	3%-6%	(2)
37%	(1)	9%	(1)
43%-45%	(2)	13%	(1)

37. Included in Confidential Exhibits C-1 through C-11 are, for each Plaintiff, (i) the total number of barrels of taxable crude oil produced by each Plaintiff during the period at issue, (ii) the number of barrels of taxable crude oil with respect to which the NIL operated to reduce each such Plaintiff's WPT liability, (iii) each Plaintiff's gross WPT liability before application of the NIL, and (iv) each Plaintiff's net WPT liability after application of the NIL.

38. In computing the NIL under the WPT Act, none of the Plaintiffs claimed any deduction for or otherwise

took into account the WPT paid or accrued during the period at issue.

Payment and Filing Requirements.

39. Pursuant to the requirements of I.R.C. § 4995(b) and Treas. Reg. § 51.4995-3, each Plaintiff during the period at issue remitted the WPT to a Federal depository on a semi-monthly basis.

40. Plaintiffs are required to file quarterly Federal excise tax returns on Form 720, accompanied by Form 6047 computing their quarterly WPT liability with respect to (a) their own taxable crude oil production and (b) WPT withheld from payments to others. Copies of Forms 720 and 6047 and the accompanying instructions, including both the Forms applicable during the period 1980-1981 and the current Forms, are attached hereto as Exhibits II and III, respectively.

41. Plaintiffs are also required to file Form 6248 ("Annual Information Return of Windfall Profit Tax") after the close of each calendar year, reporting their WPT liability for that year in respect of their own production. Plaintiffs also file Forms 6248 with respect to WPT withheld from payments to others and furnish each payee a copy of the Form so filed. Attached hereto as Exhibit IV is a copy of Form 6248 and the accompanying instructions.

42. Attached hereto as Confidential Exhibits F-1 and F-2 are representative copies of the Forms 6248 completed and filed by Plaintiffs Exxon and Atlantic during their respective periods at issue.

43. Credits or refunds of WPT attributable to overwithholding or to the application of the NIL may be claimed on Form 6249, a copy of which, including the instructions thereto, is attached hereto as Exhibit V.

44. Attached hereto as Confidential Exhibits G-1 and G-2 are representative copies of the Forms 6249 (without schedules) completed and filed by Plaintiffs Atlantic and Exxon during their respective periods at issue. Confidential Exhibit G-1 does not include a computation in Part V of Form 6249, reflecting the "net income" computation on a property-by-property basis. Confidential Exhibit G-2 includes "net income" computations for several properties. The numbered lines on Confidential Exhibit G-2 generally correspond to the numbered lines in Part V of Form 6249, a copy of which is included in Confidential Exhibit G-1.

MISCELLANEOUS INFORMATION RE PLAINTIFFS.

45. Attached hereto as Exhibits VI-1 through VI-11 are copies of the Securities and Exchange Commission Forms 10-K of each of the Plaintiffs for their respective periods at issue, including their respective annual reports and financial statements.

46. Attached hereto as Exhibits VII-1 through VII-11 are pages from Plaintiffs' Annual Reports or Forms 10-K, reflecting certain information on a per barrel basis. As noted thereon, certain of the Exhibits are taken from 1982 Forms 10-K.

ASSESSMENT AND ENFORCEMENT PRACTICES OF THE DIRECTOR.

47. It is the policy of the Director (i) under N.J.S.A. 54:10A-4(k)(2)(C) to disallow deductions for the Federal corporate income tax, including the Federal income tax on tax preference items, in the computation of Entire Net Income under the CBT Act, and (ii) under N.J.S.A. 54:10A-4(k)(2)(A) to disallow credits for the Federal investment tax credit (I.R.C. § 38), overpayments and deposits of Federal income tax (the "WIN" credit) (I.R.C. § 40), the new employees job credit (I.R.S. § 44B), the foreign tax credit (I.R.C. § 33), the

research credit (I.R.C. § 44F) and the employee stock ownership credit (I.R.C. § 44G).

48. It is also the position of the Director that no credit or deduction may be taken under the New Jersey Gross Income Tax Act, N.J.S.A. 54A:1-1 *et seq.*, for the WPT. As of the date hereof, the New Jersey Division of Taxation (the "Division"), to the best knowledge of its personnel, has neither imposed nor proposed any assessments under the New Jersey Gross Income Tax Act in respect of the treatment of the WPT in returns filed under that Act.

49. Attached hereto as Exhibit VII is a copy of a letter dated May 26, 1981 from the then Director, Sidney Glaser, to Stephen L. Taylor, Prentice-Hall, Inc., stating the position of the Director concerning the treatment of the WPT under the CBT Act and the New Jersey Gross Income Tax Act.

50. Attached hereto as Confidential Exhibit H is a statement concerning the Director's issuance of assessment notices under the CBT Act in respect of the WPT to corporations other than the Plaintiffs, Amerada Hess Corporation, Texaco, Inc., and Tenneco Oil Company.

Respectfully submitted,

PLAINTIFF CORPORATIONS

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By: /s/ Mary R. Hamill
MARY R. HAMILL
Deputy Attorney General

Dated: May 11, 1984

STIPULATION OF FACTS

INDEX TO EXHIBITS

* Chevron is a wholly-owned subsidiary of Standard Oil Company of California ("SOCAL"). The Form 10-K annexed hereto as Exhibit VI-10 is the Form 10-K filed by SOCAL during the period at issue.

** The sources of the per-barrel information included in Exhibits VII-1 through VII-11 are the Annual Reports or the Forms 10-K filed by the Plaintiffs during the period at issue or in certain cases during the year 1982.

*** These CBT Returns are exhibits to the Complaints and Amended Complaints filed herein and are on file with the Court.

Document	Exhibit Designation
Gulf	A-9
Chevron	A-10
Conoco	A-11
Separate Company (Pro Forma) Federal Income Tax Returns Prepared by Each of the Plaintiffs—	
Diamond	B-1
Shell	B-2
Cities	B-3
Exxon	B-4
ARCO	B-5
Union	B-6
Mobil	B-7
Phillips	B-8
Gulf	B-9
Chevron	B-10
Conoco	B-11
Schedules for Each Plaintiff Reflecting Crude Oil Production Data and Certain Information Concerning the Net Income Limitation—	
Diamond	C-1
Shell	C-2
Cities	C-3
Exxon	C-4
ARCO	C-5
Union	C-6
Mobil	C-7
Phillips	C-8
Gulf	C-9
Chevron	C-10
Conoco	C-11

Document	Exhibit Designation
Schedule Reflecting Lost Barrels of Crude Oil for Certain Plaintiffs	D-1
Schedule Identifying the Plaintiffs In Exhibit D-1	D-2
Schedule Reflecting the Computation of Adjusted Base Prices by One Plaintiff	E
Form 6248 of Exxon	F-1
Form 6248 of ARCO	F-2
Form 6249 of ARCO	G-1
Form 6249 of Exxon	G-2
Statement of the Director *Re* CBT Assessment Notices	H

STIPULATION EXHIBIT I

Inflation Adjustment Factor

Year	Month	Factor: Tier 1 & 2	Factor: Tier 3
1980	03	.0195	.0246
1980	04	.0422	.0527
1980	05	.0422	.0527
1980	06	.0422	.0527
1980	07	.0649	.0810
1980	08	.0649	.0810
1980	09	.0649	.0810
1980	10	.0924	.1144
1980	11	.0924	.1144
1980	12	.0924	.1144
1981	01	.1187	.1469
1981	02	.1187	.1469
1981	03	.1187	.1469
1981	04	.1404	.1750
1981	05	.1404	.1750
1981	06	.1404	.1750
1981	07	.1680	.2095
1981	08	.1680	.2095
1981	09	.1680	.2095
1981	10	.1861	.2344
1981	11	.1861	.2344
1981	12	.1861	.2344
1982	01	.2126	.2683
1982	02	.2126	.2683
1982	03	.2126	.2683
1982	04	.2410	.3045
1982	05	.2410	.3045
1982	06	.2410	.3045
1982	07	.2523	.3230
1982	08	.2523	.3230
1982	09	.2523	.3230
1982	10	.2736	.3522
1982	11	.2736	.3522
1982	12	.2736	.3522
1983	01	.2875	.3737
1983	02	.2875	.3737
1983	03	.2875	.3737
1983	04	.3001	.3941
1983	05	.3001	.3941
1983	06	.3001	.3941
1983	07	.3183	.4207
1983	08	.3183	.4207
1983	09	.3183	.4207

Form **6249**
(Rev. January 1984)
Department of the Treasury
Internal Revenue Service

Computation of Overpaid Windfall Profit Tax

► See separate instructions.

OMB No. 1545-0226

80

Name	Taxpayer identifying number

PART I.—Type of Return to Which Form 6249 Is Attached

- ☐ Form 720
- ☐ Form 843
- ☐ Form 1040 (and Form 1040NR)
- ☐ Form 1040X
- ☐ Form 1041
- ☐ Form 1120
- ☐ Form 1120F
- ☐ Form 1120X
- ☐ Other Form 1120 (Form 1120-DISC, Form 1120L, Form 1120M, etc.)
- ☐ Form 990-C or Form 990-T
- ☐ Other ►

PART II.—Overpayment Due to a Withholding Error.—For calendar year ►

1 Please check the applicable box for the status that resulted in a withholding error

- ☐ Exempt qualified governmental interest (section 4991(b)(1))
- ☐ Exempt qualified charitable interest (section 4991(b)(1))
- ☐ Exempt Indian oil (section 4991(b)(2))
- ☐ Exempt Alaskan oil (section 4991(b)(3))
- ☐ Exempt royalty owner oil (section 4991(b)(5)) (trusts do not qualify)
- ☐ Exempt independent producer of stripper well oil (section 4991(b)(6))
- ☐ Independent producer oil (section 4992)
- ☐ Trust beneficiary credit or refund (section 6430)
- ☐ Other (attach explanation)

2 Amounts withheld for oil removed during the calendar year (attach Form(s) 6248)	2	
3 Correct amount of tax (see instructions)	3	
4 Overpayment due to a withholding error (subtract line 3 from line 2)	4	

PART III.—Overpayment Resulting From the Net Income Limitation

5 Enter amount from line 19 (Part V)	5	

PART IV.—Combined Overpayment of Windfall Profit Tax

6 Total amount of credit or refund (add lines 4 and 5) (see instructions)	6	

For Paperwork Reduction Act Notice, see page 1 of the instructions.

Form 6249 (Rev. 1-84)

Form 6249 (Rev. 1-84) Page 2

PART V.—Net Income Limitation—For tax year beginning 19 , and ending 19

Property	Name of Property	Identification Number	Date of Acquisition
A			
B			
C			
D			
E			
F			

Gross Income	A	B	C	D	E	F
1 Gross income (see instructions)						
2 Reductions						
(a) Gas removals						
(b) Exempt oil removals						
(c) Total (add lines 2(a) and 2(b))						
3 Gross income from removal of taxable oil (subtract line 2(c) from line 1)						
***Expenses** solely attributable to the production of taxable crude oil (lines 4 through 9)*						
4 Production and severance tax						
5 Lease operating expenses						
6 Depreciation						
7 Overhead						
8 Cost depletion computed under section 4988(b)(3)(C) and regulations section 51.4988-2(b)(3) (see instructions)						
9 Other expenses (see instructions)						
10 Proportionate share of expenses not solely attributable to the production of taxable crude oil (see instructions)						
11 Total expenses for the property (add lines 4 through 10)						
12 Taxable income from the property (subtract line 11 from line 3)						
13 Number of taxable barrels of crude oil sold from the property during the tax year						
14 Divide line 12 by line 13 (net income per barrel)						
15 Multiply line 14 by 90% (net income limitation per barrel)						
16 Windfall profit tax computed on the lower of (a) windfall profit per barrel, or (b) net income limitation per barrel (see instructions)						
17 Tax paid or deemed paid						
18 Amount of overpayment (subtract line 16 from line 17) (or underpayment—subtract line 17 from line 16)						

19 Total amount of overpayment. Enter here and on line 5, page 1 (If an underpayment, see instructions)	

DIAMOND SHAMROCK, *et al.*

STIPULATION OF FACTS

Confidential Stipulation

Exhibit H

As of the date of the Stipulation of Facts in this matter, in addition to assessment notices issued to the Plaintiffs, Amerada Hess Corporation, Texaco, Inc., and Tenneco Oil Company, the Director had issued assessment notices under the CBT Act in respect of the WPT to two chemical companies and one conglomerate.

TAX COURT OF NEW JERSEY

Docket Nos.
CB 065B-83 CB 072B-83
CB 066B-83 CB 073B-83
CB 068B-83 CB 074B-83
CB 070B-83 CB 075B-83
CB 071B-83
Civil Action

DIAMOND SHAMROCK CORPORATION, SHELL OIL COMPANY, EXXON CORPORATION, UNION OIL COMPANY OF CALIFORNIA, MOBIL OIL CORPORATION, PHILLIPS PETROLEUM COMPANY, GULF OIL CORPORATION, CHEVRON U.S.A. INC., and CONOCO INC.,

Plaintiffs,

-vs-

DIRECTOR, DIVISION OF TAXATION,

Defendant.

SUPPLEMENTARY STIPULATION OF FACTS

Pursuant to paragraph 10 of each of the Pretrial Orders entered in these actions, and subject to the right of any party hereto (i) to contest the evidentiary issues of relevancy and materiality and (ii) to further supplement this Supplementary Stipulation by other evidence not inconsistent herewith,

IT IS HEREBY STIPULATED AND AGREED that, for the purposes of these actions, the following statements may be accepted as facts and all exhibits referred to herein and attached hereto are incorporated into this Supplementary Stipulation and made a part hereof:

SCOPE OF STIPULATION.

1. This Supplementary Stipulation relates to information furnished to the defendant, Director, Division of Taxation (the "Director"), by each of the nine party plaintiffs hereto (the "Plaintiffs") in response to Interrogatories heretofore propounded by the Director in these actions. Specifically, the facts herein stipulated relate to the Fifth Claim for Relief of the respective Complaints or Amended Complaints, as the case may be, filed in these actions by the nine Plaintiffs, alleging violations of the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution and of the equal protection guarantees of Article I, paragraph 1, and Article IV, section 7, paragraph 9(6), of the New Jersey Constitution (1947).

2. Each of the Plaintiffs is also a party to and is identified in a Stipulation of Facts of even date, entered in these actions (the "Stipulation of Facts"). As herein pertinent, the facts and exhibits included in said Stipulation of Facts are incorporated by reference into this Supplementary Stipulation as though fully set forth herein.

3. Except to the extent otherwise provided herein, the terms used in this Supplementary Stipulation shall have the same meanings as are ascribed thereto in paragraph 1 of the Stipulation of Facts.

4. Most of the facts herein stipulated are confidential in nature and, therefore, subject to the terms and provisions of the Consent Protective Orders heretofore entered in these actions. Consistent therewith, each Plaintiff is identified in this Supplementary Stipulation by number only. Attached hereto as Confidential Exhibit A* is a schedule identifying each such Plaintiff by name and number.

---

* The designation "Confidential Exhibit ——", as used herein, indicates that the exhibit is subject to the terms of the Consent Protective Orders entered herein and is, therefore, submitted herewith under sealed separate cover.

PETROCHEMICAL ACTIVITIES.

5. All nine Plaintiffs entering into this Supplementary Stipulation other than Plaintiff 2, are engaged in the manufacture and marketing/sale of chemical products, including petrochemicals derived from crude oil.

6. Plaintiff 2 manufactures petrochemical feedstocks, representing refined by-products of crude oil and natural gas, but does not manufacture petrochemicals. The feedstocks of Plaintiff 2 are processed by a third party pursuant to contractual agreement. Plaintiff 2 then markets and sells the resulting petrochemicals derived from crude oil.

7. The petrochemicals so manufactured and marketed or sold by these Plaintiffs include petrochemicals made or processed from taxable crude oil which is subject to the WPT Act. The Plaintiffs are liable for the WPT with that crude oil.

8. Of the nine Plaintiffs, six do not keep or maintain records differentiating between the percentage of their net income derived from the manufacture and sale of petrochemicals using crude oil and that derived from the manufacture and sale of petrochemicals using natural gas. Of the remaining three Plaintiffs, Plaintiff 4 derived approximately 4% of its separate company net income during the period at issue from the manufacture and sale of petrochemicals using crude oil; Plaintiff 3 derived 1.9% of its consolidated earnings during that period from its United States petrochemical operations using crude oil; and Plaintiff 2 had no net income during that period from the marketing and sale of petrochemicals using crude oil.

9. Of the six Plaintiffs which did not maintain records of the type described in paragraph 8 of this Supplementary Stipulation, four do maintain records reflecting the percentage of their net income or consolidated earnings derived from the manufacture and sale of petrochemicals,

both those using crude oil and those using natural gas. The applicable percentages so reflected for each of these Plaintiffs are set forth in Confidential Exhibit B hereto.

10. The cost of the taxable crude oil constituent of each petrochemical using crude oil is a component of the cost of that petrochemical.

11. Attached hereto as Confidential Exhibit C is a schedule reflecting the following information with respect to the petrochemical operations of Plaintiff 3: (a) the major petrochemicals manufactured and sold; (b) the per unit cost of the crude oil constituent of each such petrochemical; and (c) the WPI cost component of the foregoing per unit crude oil constituent cost.

12. Attached hereto as Confidential Exhibit D is a schedule reflecting the following information with respect to the petrochemical operations of Plaintiff 4: (a) the major petrochemicals manufactured and sold; (b) the per unit manufacturing cost of each such petrochemical; and (c) the average per unit cost of the crude oil constitutent of the petrochemicals manufactured and marketed by Plaintiff 4.

13. There exist non-oil producing chemical companies which are engaged in the manufacture and sale/marketing of petrochemicals. These chemical companies are also engaged in business in New Jersey, including the marketing or sale of petrochemicals. Attached hereto as Exhibit 1 is a representative list of such companies.

14. The non-oil producing chemical companies identified in Exhibit 1 purchase the crude oil constituent of their petrochemical products from, among others, oil producers, both integrated and non-integrated, including certain of the Plaintiffs. Attached hereto as Confidential Exhibits E to H are schedules reflecting for Plaintiffs 1, 3, 5 and 7, respectively, the following information: (a) the major petrochemicals manufactured and sold; and (b) the petrochemicals manufactured and/or marketed by each Plaintiff's non-oil producing chemical company competitors engaged in business in New Jersey.

Respectfully submitted,

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Attorneys for Plaintiff

Stryker, Tams & Dill

By: /s/ Charles M. Costenbader
Charles M. Costenbader

Dated: May 11, 1984

SUPPLEMENTARY STIPULATION OF FACTS

EXHIBIT 1

Representative List of Non-Oil Producing Chemical Companies Engaged in Business in New Jersey

Union Carbide Corp.

Texas Eastman Company

Gill & Duffus Chemicals Inc.

McKesson Chemical Co.

Devon Chemicals Inc.

Borden Inc.

Celanese Chemical Co., Inc.

ICC Industries Inc.

Phillips Brothers Chemical, Inc.

EXCERPT FROM MONTHLY ENERGY REVIEW (MAY 1983)

ENERGY INFORMATION ADMINISTRATION U.S. DEPARTMENT OF ENERGY

Petroleum Price Summary

	Actual Domestic Average	Refiner Acquisition Cost of Crude Oil			No. 6 Residual Oil Price Average	
	Wellhead Price	Domestic	Imported	Composite	Wholesale	Retail
			Dollars per barrel			
1976 AVERAGE	8.19	8.84	13.48	10.89	10.72	11.49
1977 AVERAGE	8.57	9.55	14.53	11.96	11.96	13.23
1978 AVERAGE	9.00	10.61	14.57	12.46	11.51	12.75
1979 AVERAGE	12.64	14.27	21.67	17.72	17.66	18.67
1980 AVERAGE	21.59	24.23	33.89	28.07	23.14	26.09
1981 January	28.85	32.71	38.85	34.86	31.14	33.65
February	34.14	36.27	39.00	37.28	31.81	36.04
March	34.70	36.97	38.31	37.48	31.78	36.11
April	34.05	35.58	38.41	36.58	30.56	34.70
May	32.71	35.21	37.84	36.11	30.41	34.11
June	31.71	34.20	37.03	35.03	25.95	31.03
July	31.13	33.76	36.58	34.70	26.52	30.57
August	31.13	33.79	35.82	34.46	27.01	30.52
September	31.13	33.47	35.44	34.11	26.20	30.33
October	31.00	33.48	35.43	34.07	26.78	30.32
November	30.98	33.49	36.21	34.33	27.99	30.16
December	30.72	33.51	35.95	34.33	27.26	30.90
AVERAGE	31.77	34.33	37.05	35.24	28.96	32.50
1982 January	30.87	33.39	35.54	33.95	27.07	29.83
February	29.76	32.71	35.48	33.40	26.29	30.02
March	28.31	31.08	34.07	31.81	25.73	29.50
April	27.65	30.27	32.82	30.83	25.46	28.21
May	27.67	30.37	32.78	31.02	26.52	28.93
June	28.11	30.79	33.79	31.74	26.62	29.59
July	28.33	30.92	33.44	31.74	25.97	29.33
August	28.18	30.85	32.95	31.45	26.34	28.44
September	27.99	30.76	33.03	31.40	26.49	28.43
October	28.74	31.38	33.28	31.98	27.52	29.28
November	28.70	31.57	33.09	32.07	28.31	29.84
December	28.12	30.80	32.85	31.29	26.81	28.47
AVERAGE	28.52	31.22	33.55	31.87	26.55	29.08
1983 January	27.22	30.55	R31.40	R30.73	NA	NA
February	26.41	29.25	30.87	29.61	NA	NA
March	NA	NA	NA	NA	NA	NA

Geographic coverage: the 50 United States and the District of Columbia, except for the refiner acquisition cost of crude oil, which is the 50 United States, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands. [Footnotes omitted]

SUPREME COURT OF THE UNITED STATES

No. 87-453 and 87-464

AMERADA HESS CORPORATION, *et al.*,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY; and

TEXACO, INC. and TENNECO OIL COMPANY,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY

The Solicitor General is invited to file briefs in these cases expressing the views of the United States.

November 9, 1987

Justice O'Connor took no part in the consideration or decision of this order.

SUPREME COURT OF THE UNITED STATES

No. 87-453

AMERADA HESS CORPORATION, *et al.*,
Appellants
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY

Appeal from the Supreme Court of New Jersey

The statement of jurisdiction in this case having been submitted and considered by the Court, in this case probable jurisdiction is noted. This case is consolidated with 87-464 *Texaco, Inc. and Tenneco Oil Company v. Director, Division of Taxation, New Jersey Department of the Treasury*, and a total of one hour is allotted for oral argument.

May 16, 1988

Justice O'Connor took no part in the consideration or decision of this case.

A true copy
JOSEPH F. SPANIOL, JR.

Test:

Clerk of the Supreme Court
of the United States

By /s/ [Illegible]
Deputy

SUPREME COURT OF THE UNITED STATES

No. 87-464

TEXACO, INC. and TENNECO OIL COMPANY,
Appellants
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY

Appeal from the Supreme Court of New Jersey

The statement of jurisdiction in this case having been submitted and considered by the Court, in this case probable jurisdiction is noted. This case is consolidated with 87-453 *Amerada Hess Corporation, et al. v. Director, Division of Taxation, New Jersey Department of the Treasury*, and a total of one hour is allotted for oral argument.

May 16, 1988

Justice O'Connor took no part in the consideration or decision of this case.

A true copy
JOSEPH F. SPANIOL, JR.

Test:

Clerk of the Supreme Court
of the United States

By /s/ [Illegible]
Deputy

(10) (9)

Nos. 87-453 and 87-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

AMERADA HESS CORPORATION, *et al.*,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeals from the Supreme Court of New Jersey

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QUESTION PRESENTED

Whether the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution permit a state, in defining the taxable net income of a multistate corporation, to include income derived from an exclusively out-of-state business activity but to deny an offset for associated costs incurred solely on account of that activity.

LIST OF PARTIES AND RULE 28.1 STATEMENT

This brief is filed on behalf of the following appellants, each of whom was a party in the Supreme Court of New Jersey:

Amerada Hess Corporation
Atlantic Richfield Company
Chevron U.S.A. Inc.
Cities Service Company
Conoco Inc.
Exxon Corporation
Gulf Oil Corporation
Mobil Oil Corporation
Phillips Petroleum Company
Shell Oil Company
Tenneco Oil Company
Texaco Inc.
Union Oil Company of California

The remaining parties in the Supreme Court of New Jersey were:

Diamond Shamrock Corporation
Director, Division of Taxation, New Jersey
Department of the Treasury

The lists of appellants' affiliates required by Rule 28.1 are set forth in Appendix I (pp. 105a-155a) to the Jurisdictional Statement in No. 87-453 and Appendix G (pp. 70a-72a) to the Jurisdictional Statement in No. 87-464. Amendments to those lists to make them currently accurate are set forth in Appendix D to this brief, *infra*, at 11a-20a.

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TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 87-453

AMERADA HESS CORPORATION, *et al.*,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

No. 87-464

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,
v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeals from the Supreme Court of New Jersey

BRIEF FOR APPELLANTS

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (J.S. App. 1a-35a)[1] is reported at 107 N.J. 307, 526 A.2d 1029. The opinion of the Appellate Division of the Superior Court of New Jersey (J.S. App. 36a-42a) is reported at 208 N.J. Super. 201, 505 A.2d 186. The opin-

[1] "J.S. App." refers to the Appendix to the Jurisdictional Statement in No. 87-453. "Texaco J.S. App." refers to the Appendix to the Jurisdictional Statement in No. 87-464. "J.A." refers to the Joint Appendix in these consolidated appeals.

ion of the Tax Court of New Jersey (J.S. App. 43a-49a) is reported at 7 N.J. Tax 51, and its opinion denying reconsideration (J.S. App. 50a-61a) is reported at 7 N.J. Tax 275.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on June 22, 1987. J.S. App. 1a. Notices of appeal to this Court were timely filed in the Supreme Court of New Jersey on August 20 and 21, 1987. J.S. App. 62a-83a; Texaco J.S. App. 56a-61a. These appeals were docketed on September 18, 1987, and the Court noted probable jurisdiction on May 16, 1988. J.A. 43-44. The jurisdiction of this Court rests on 28 U.S.C. § 1257 (2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The relevant provisions of the United States Constitution, the New Jersey Corporation Business Tax Act, and the Crude Oil Windfall Profit Tax Act of 1980 are set forth at J.S. App. 92a-104a.

STATEMENT

Appellants are 13 vertically integrated oil and gas companies. They engage in all aspects of the petroleum business, including exploration, production, refining, transportation, distribution, and marketing. J.S. App. 2a; J.A. 11. They do business and own property throughout the United States. J.A. 11-12.

Appellants produce no crude oil in New Jersey. J.S. App. 2a. The state has no oil production and no proven oil reserves.[2] Several of the appellants do conduct refining operations in New Jersey, and all of them market

[2] U.S. Department of Energy, *Petroleum Supply Annual 1986*, Vol. I, Table 9, at 31 (May 1987); U.S. Department of Commerce, *State and Metropolitan Area Data Book 1986*, at 585.

petroleum products in that state. J.S. App. 2a; J.A. 12-15. They compete at both the wholesale and retail levels not only with each other but also with non-producer independent refiners and marketers.

As a producer of crude oil, each appellant is subject to the federal Crude Oil Windfall Profit Tax ("WPT"), an excise tax imposed on the "removal" of each barrel of crude oil from the producing premises. In addition, as a company that does business in New Jersey, each appellant is subject to the New Jersey Corporation Business Tax ("CBT"), a franchise tax measured by a corporation's "entire net income." The interaction of those two tax schemes, each of which is summarized below, gives rise to the present controversy.

Under the CBT, New Jersey taxes an apportioned share of a corporation's "entire net income" from all sources, both in-state and out-of-state. It accordingly required each appellant to include in its preapportionment tax base the income contributed by its out-of-state oil production activities. This Court held in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980), that a non-production state could lawfully tax an apportioned share of income derived from an integrated company's out-of-state oil production, and no appellant objects to that aspect of New Jersey's tax scheme.

But here is the rub. Unlike Wisconsin in the *Exxon* case, New Jersey includes in its tax base the out-of-state oil production income but leaves behind a significant portion of the offsetting oil production costs. It reaches that result by defining "entire net income" to preclude a deduction for the billions of dollars in WPT payments that appellants and others have made to the federal government since 1980. The WPT is a production cost necessarily incurred in the "removal" of crude oil—an activity that takes place, and can only take place, exclusively outside New Jersey. No comparable cost incurred on account

of any in-state activity is accorded similarly disadvantageous tax treatment under the CBT.

Appellants contend that the New Jersey tax scheme, by thus selecting for disallowance a major cost of exclusively out-of-state oil production, has two fundamentally impermissible consequences. First, it generates a geographically asymmetrical "entire net income" base, composed of income from everywhere less *all* costs incurred within New Jersey but only *some* costs incurred outside New Jersey. Because the state starts with a geographically unbalanced net income base, its otherwise unobjectionable apportionment formula necessarily subjects to New Jersey taxation a greater portion of appellants' multistate income than is fairly attributable to the business done there.

Second, the New Jersey statute unlawfully discriminates against interstate commerce by imposing unique tax burdens on a class of taxpayers solely because they engage in a form of business activity conducted exclusively outside the state's borders. Although the discrimination does not favor an identical activity within New Jersey—no crude oil is produced there—it nonetheless impairs free trade by assigning a disproportionate share of the local tax burden to a segment of interstate commerce, thereby saddling it with a competitive handicap in the domestic New Jersey market.

Before describing the state court's handling of these issues, we briefly outline the relevant features of the WPT and the CBT.

A. The Windfall Profit Tax

1. *Background*

During the 1970s, the domestic oil industry was subject to an elaborate system of price and allocation controls. The system was gradually dismantled between 1975 and 1981, when all regulatory authority was terminated. In late 1979 and 1980, shortly after President Carter began phasing out crude oil price controls, the world market price for crude oil soared, and the President and Congress became acutely sensitive to the political implications of allowing domestic producers to obtain the full benefit of the substantially higher uncontrolled prices. In the Crude Oil Windfall Profit Tax Act of 1980, I.R.C. §§ 4986 *et seq.*, Congress addressed that concern by imposing "an excise tax on the additional revenue resulting from decontrol." *United States v. Ptasynski*, 462 U.S. 74, 76 (1983). "Without such a tax, decontrol probably could not [have gone] forward." Staff of Jt. Comm. on Taxation, *General Explanation of the Crude Oil Windfall Profit Tax Act of 1980*, at 26 (Jt. Comm. Print 1981) [hereinafter *General Explanation*].

The tax was intended to reserve for the federal treasury a "fair share" of the economic benefits of deregulation, thereby achieving "greater equity in the distribution of the gains from higher oil prices." S. Rep. No. 394, 96th Cong., 1st Sess. 6 (1979). Congress sought to "strike the appropriate balance between tax receipts that could be used for public investment or redistribution and industry incentives to increase domestic oil production." Cong. Budget Office, *The Windfall Profits Tax: A Comparative Analysis of Two Bills* xv (Nov. 1979); *see* S. Rep. No. 394, *supra*, at 6-7; H.R. Rep. No. 304, 96th Cong., 1st Sess. 4-5 (1979); *General Explanation* 6, 26.

2. *Incidence, Measure, and Tax Rate*

By its terms, the WPT is "[a]n excise tax . . . on the windfall profit from taxable crude oil removed from the premises during each taxable period." I.R.C. § 4986(a). The event that triggers the tax is the removal of a barrel of crude oil from the producing premises. A barrel is "removed" when it is brought to the surface and "physically transported" away from the "immediate vicinity of the well." Treas. Reg. § 51.4996-1(d)(1). If the refining process begins before the barrel is physically removed

from the premises, it is "treated as removed on the day such manufacture or conversion begins." I.R.C. § 4988 (c) (4) (A).

The WPT thus operates as a transactional tax. Liability attaches upon removal of each barrel of crude oil regardless of what happens to that barrel thereafter. *See* H.R. Conf. Rep. No. 817, 96 Cong., 2d Sess. 106 (1980); S. Rep. No. 394, *supra*, at 66; H.R. Rep. No. 304, *supra*, at 43. The producer must pay the tax even if the removed barrel is subsequently lost or for any other reason fails to yield income to the producer.

The measure of the tax—the so-called "windfall profit"—is likewise linked to the physical act of removing a barrel of crude oil. In simple terms, the "windfall profit" is the portion of each barrel's value, determined at the time and place of removal, that is attributable to federal price decontrol. This decontrol increment is computed separately for each barrel and is equal to the "removal price" of the barrel less the sum of its "adjusted base price" and the "severance tax adjustment." § 4988(a).

If the barrel is removed after a sale, the removal price is the actual sales price. § 4988(c) (1). If the barrel is removed prior to sale (for example, if it is transported to the producer's refinery for processing), the removal price is the "constructive sales price"—generally "the representative market or field price of the oil" before removal from the premises. § 4988(c) (3); Treas. Reg. § 1.613-3(a). The "adjusted base price" is the approximate price, adjusted for inflation, at which the barrel would have been sold in 1979 (before price decontrol). § 4989(a). The "severance tax adjustment" is the amount by which any state severance tax imposed on a barrel exceeds the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. § 4996(c).

The Act divides domestic crude oil into three tiers and assigns to each an adjusted base price and a tax rate ranging from 30 to 70 percent. I.R.C. §§ 4987(b), 4989, 4991. The amount of tax with respect to each barrel of crude oil is computed by multiplying the "windfall profit on such barrel" by the applicable tax rate. § 4987(a).

3. *"Net Income Limitation"*

Congress included in the Act a "net income limitation" ("NIL") designed "[t]o prevent the tax from burdening high-cost properties." S. Rep. No. 394, *supra*, at 29; H.R. Rep. No. 304, *supra*, at 2. Under the NIL, the "windfall profit" on a barrel may not exceed "90 percent of the net income attributable to such barrel." § 4988(b) (1).

"Net income" for purposes of the NIL is a term of art that differs materially from the ordinary meaning of the phrase. First, it refers, not to the producer's overall net income from operations, but rather to its per barrel "taxable income from the property." § 4988(b) (2). A producer may have many properties, some profitable and others unprofitable, depending on the acquisition, development, and operating costs of each. "Taxable income from the property," and therefore the NIL for each barrel, must be computed separately for each such property, and losses on one do not offset gains on another. Treas. Reg. § 51.4988-2(b) (1) (i). Consequently, a producer may have, in the same tax year, substantial WPT liability despite having no taxable income for federal income tax purposes.

Second, "income" for NIL purposes does not depend on realization. Like the "removal price," it is computed on the basis of a "constructive sales price" for each barrel removed prior to sale. § 4988(b) (3); Treas. Reg. § 1.613-3(a). The constructive price is used regardless of how much (if any) income is later realized on that barrel.

In sum, although the NIL can limit the amount of a producer's WPT liab... it does not affect the fundamental character of the WPT as a per barrel transactional tax on specific events that occur at an identifiable time and place.

4. *Federal Income Tax Treatment*

For federal income tax purposes, WPT payments are treated by most companies as inventoriable production costs under I.R.C. § 471. When a company sells crude oil or refined products, it transfers its WPT and other inventoriable costs out of inventory as "costs of goods sold," thereby matching them with the sales proceeds in determining gross income. Alternatively, some taxpayers deduct WPT payments in the year paid either as "ordinary and necessary" business expenses under I.R.C. § 162 or as taxes under I.R.C. § 164, which specifically allows a current deduction for WPT payments.[3]

In assessing the federal tax impact of the WPT, Congress assumed that WPT payments also "generally would be deductible under State income taxes." H.R. Rep. No. 304, *supra*, at 9; *see* H.R. Conf. Rep. No. 817, *supra*, at 163; S. Rep. No. 394, *supra*, at 9; *General Explanation* at 9.

B. The New Jersey Corporation Business Tax

New Jersey imposes an annual tax (the CBT) measured by the "entire net income" of each corporation that does business in the state. N.J. Stat. Ann. § 54:10A-5(c) (West 1986). If a corporation does business both within and without the state, the CBT is imposed on the portion of the corporation's "entire net income" that is attributable to New Jersey under a three-factor apportionment formula representing New Jersey's share of the corporation's total property, receipts, and payroll. *Id.* § 54:10A-6.[4]

[3] We occasionally use "deduction" in this brief in the broadest sense to embrace any item subtractible either from gross receipts to determine gross income or from gross income to determine taxable income.

Federal taxable income is the starting point for determining "entire net income" under the CBT. A taxpayer's "entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax." *Id.* § 54:10A-4(k).

The statute specifies—in what the New Jersey Supreme Court referred to as the "add-back" provision (J.S. App. 2a)—that certain federal deductions must be "added back" to federal taxable income for purposes of the CBT. One of the add-back items is a category of federal taxes to the extent deducted on the federal return. The statute provides that "[e]ntire net income shall be determined without the exclusion, deduction or credit of . . . [t]axes paid or accrued to the United States on or measured by profits or income." N.J. Stat. Ann. § 54:10 A-4(k)(2)(C) (West 1986).[5]

[4] For the years in issue, the New Jersey CBT imposed a concurrent tax on a similarly apportioned share of a corporation's "entire net worth." N.J. Stat. Ann. § 54:10A-5(a) (West 1986). The application of the net worth tax is not at issue in these appeals.

[5] The add-back provision operates to adjust the federal starting point. It therefore reaches only items that are deductible in computing federal taxable income. Because federal income tax paid or accrued in a particular year is not deductible in computing federal taxable income for that year, it need not be "added back" in computing New Jersey "entire net income." *Cf. Texaco, Inc. v. Director, Division of Taxation*, 4 N.J. Tax 63, 66 (1982) ("'entire net income' . . . is identical with federal taxable income" except as specifically adjusted by statute; federal minimum tax for tax preferences is therefore not excludable in computing New Jersey "entire net income"). New Jersey's federal tax add-back provision consequently had been dormant prior to this litigation.

Many states employ comparable provisions denying deductions for state or federal income tax payments. The provisions are intended to prevent erosion of a state's net income tax base through the deduction of similar taxes levied by other jurisdictions on the same base.

C. The Proceedings Below

1. *The Assessments*

At issue in this litigation are the 1980 CBT returns filed by all of the appellants and the 1981 CBT returns filed by five of the appellants.[6] Each appellant, in computing its New Jersey "entire net income," adjusted its federal taxable income in accordance with the requirements of N.J. Stat. Ann. § 54:10A-4(k) (West 1986). No appellant added back WPT costs to federal taxable income. J.A. 16. All considered the WPT to be a federal excise or severance tax imposed on the production of crude oil and measured by the value of the crude oil at the wellhead, not a tax on or measured by corporate income or profit within the scope of the New Jersey add-back provision.

The Director of the Division of Taxation, New Jersey Department of the Treasury, issued CBT deficiency assessments to appellants (resulting in certain cases in the reduction or disallowance of refunds requested because of overpayments). The Director expressly based the assessments and refund denials on the failure of appellants to add back their WPT payments in computing "entire net income." Each appellant filed a protest. After conferences with the appellants, the Director issued final determination letters denying the protests. J.A. 16-17.

The add-back of WPT payments made a "substantial difference" (J.S. App. 44a) to each of the appellants,

[6] The state has deferred final action, pending the outcome of this litigation, on the 1981 returns filed by the other eight appellants and on the subsequent years' returns filed by all but one of the appellants.

increasing their New Jersey tax liability by an average of 22 percent in tax year 1980 (even though federal price controls were still largely in place) and 260 percent in tax year 1981 (when price controls were terminated). The amount and the percentage of each appellant's increased tax liability resulting from the add-back of WPT are tabulated in Appendix A to this brief, *infra*, at 1a.

2. *The Litigation*

a. Each appellant filed a complaint in the Tax Court of New Jersey challenging the deficiency assessment or refund denial. The litigation raised essentially two issues: (1) whether the WPT falls outside the scope of the New Jersey add-back provision because it is not a tax "on or measured by profits or income," and (2) if the WPT is within the scope of the add-back provision as construed, whether the statute, by denying an offset for costs incurred solely on account of activities conducted exclusively outside New Jersey, conflicts with the United States Constitution.

The Tax Court rejected appellants' claims on both issues. J.S. App. 43a-49a. It emphasized, in denying reconsideration, that its construction of the add-back provision turned, not on "whether the WPT *was in fact* a tax on or measured by profits or income," but rather on "what the [state] Legislature perceived it to be." J.S. App. 57a (emphasis in original).

b. On appeal, the Appellate Division of the Superior Court reversed. It determined that, "[b]ecause the WPT is payable without regard to the profitability of the oil producers' overall business activities," it "is not a tax on or measured by profits or income" and thus does not fall within the add-back provision. J.S. App. 39a, 42a. That provision's "purpose," the Appellate Division noted, is "to preserve undiluted for state taxation the same tax base upon which federal income taxes were computed." J.S. App. 41a. The provision "should not be

read to include legitimate business expenses," such as WPT costs, because adding such expenses back to the tax base could "create tax liabilities in spite of overall losses," contrary to the fundamental design of the CBT. *Id.* In light of its construction of the statute, the Appellate Division had no need to address the constitutional issues.

c. The New Jersey Supreme Court reversed the judgment of the Appellate Division and reinstated the judgment of the Tax Court. The Supreme Court acknowledged that the WPT, unlike the CBT, is "imposed on production at the wellhead" and that its measure is not a company's "overall net profits or income" but rather the incremental value of a barrel of crude oil at the wellhead resulting from decontrol. J.S. App. 5a-6a. It accordingly recognized that the WPT is not "directed at the same income base as the C.B.T." J.S. App. 33a. Nevertheless, based on "the principle of probable legislative intent" (J.S. App. 10a), it concluded that the WPT fell within the add-back provision.

Even without adding back the WPT deduction, New Jersey would enjoy a significantly expanded tax base, and materially higher tax revenues, because of the impact of price decontrol on the net income of crude oil producers. The New Jersey Supreme Court nonetheless theorized that, "if the Legislature had anticipated the enactment of the W.P.T., it would have been concerned" that the "deductibility of the W.P.T. would shrink the State's tax base." J.S. App. 11a. For that reason, according to the Court, "the Legislature probably would have viewed the W.P.T. as a tax on the 'profits' and 'income' of oil companies, thereby avoiding a revenue loss." *Id.*

The Court next considered the constitutionality of the statute as interpreted. First, it held that disallowing a deduction, even for costs incurred solely on account of out-of-state activities, does not implicate the territorial

limitations on state taxing power imposed by the Due Process Clause. So long as the state employs a constitutionally permissible "three-factor apportionment formula," it is "entitled to include" in the tax base of a unitary business "100% of [its] entire net income." J.S. App. 33a. Implicit in the Court's holding is the view that nothing in the Constitution limits the manner in which the state defines "entire net income"—that it may require add-backs, or disallow deductions, without regard to any resulting geographical imbalance in the tax base.

Second, the Court held that "[d]enial of the W.P.T. deduction does not violate the commerce clause because it does not favor in-state over out-of-state economic activity" and is "not based on the interstate nature of plaintiffs' businesses." J.S. App. 34a. The Court did not address appellants' contention that, under the Court's construction of the CBT, integrated companies, solely because they engage in the exclusively out-of-state activity of oil production, are subjected to a discriminatorily higher effective tax burden than are all other New Jersey taxpayers, including independent marketers with whom the integrated companies directly compete in New Jersey.

Finally, the Court concluded that the disparate treatment of integrated companies and independent marketers does not violate the Equal Protection Clause. According to the Court, integrated companies are in a different class because "they produce crude oil and pay the W.P.T." and because they alone benefited "from the decontrol of crude oil prices." *Id.* It did not explain why the measure of the producer's benefit under that analysis may include not only the producer's but also the federal treasury's share of those higher prices.

d. These appeals followed. On November 9, 1987, the Court invited the Solicitor General to submit a brief expressing the views of the United States. J.A. 42. On

May 16, 1988, after receipt of the Solicitor General's brief, the Court noted probable jurisdiction and consolidated the appeals. J.A. 43-44.

SUMMARY OF ARGUMENT

I

A.

A state may tax only that portion of a multistate company's net income that is fairly attributable to its business activities within the jurisdiction. *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942). Under the formula apportionment method approved by this Court, a taxing state first computes the company's total net income from all sources and then apportions to itself a share of that amount under a formula that reasonably approximates the in-state ratio of the company's income-generating activities. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 165, 169 (1983).

To avoid taxing a disproportionate share of multistate net income, the state must apply a geographically fair apportionment formula to a geographically neutral preapportionment tax base. If either component embodies an inherent geographical bias—for example, if the formula automatically gives greater weight to in-state than to out-of-state business activities, or if the preapportionment base is intrinsically slanted to include a larger percentage of out-of-state than in-state income—the state will necessarily apportion to itself more of the taxpayer's multistate income than can fairly be attributed to its business within the state, in violation of both the Due Process Clause and the Commerce Clause.

1. New Jersey uses a geographically benign three-factor apportionment formula to which no one here objects. But it applies that formula, in the case of crude oil producers, to a geographically asymmetrical preapportionment tax base. While New Jersey includes in the base all the income derived from appellants' exclusively out-of-state crude oil production activities, it simultaneously disallows, under its statutory "add-back" provision, an offset for a substantial portion of the associated costs incurred solely on account of those activities.

Unlike most commonly deductible business expenditures, which are as likely to be incurred inside as outside any particular state, windfall profit tax outlays are both site-specific and geographically localized. They are incurred only in the "removal" of crude oil—an activity that takes place, and can only take place, outside the State of New Jersey. No comparable in-state outlay is treated with the same disfavor as WPT costs. By thus singling out for disallowance this large class of necessarily extrastate costs, New Jersey artificially inflates appellants' preapportionment net income, automatically incorporating a disproportionate share of out-of-state values. Because the preapportionment base is geographically unbalanced, the amount apportioned to New Jersey by its formula is necessarily exaggerated. The result is that New Jersey inevitably taxes a larger share of appellants' multistate net income than is fairly attributable to their business within the state.

2. The New Jersey Supreme Court wrongly determined that nothing in the federal Constitution confines the state's allowance or disallowance of income tax deductions. None of the state's theories supports that conclusion.

First, neither the fairness of a state's three-factor apportionment formula nor the doctrine of "legislative grace" can insulate from constitutional scrutiny the systematic geographical tailoring of the state's preapportionment tax base. If that base is defined in a geographically uneven fashion, whether through the selective granting or denial of deductions or otherwise, even the fairest apportionment formula is impotent to prevent the improper taxation of extraterritorial values.

Second, while this Court in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980), authorized a non-production state to include in an integrated oil company's preapportionment tax base income derived from out-of-state oil production, it nowhere implied that the state could strip the income from the associated costs, taxing the former while ignoring the latter. The unitary stream of multistate income carries with it a unitary stream of costs. If a state chooses to tax an apportioned share of the income, it must treat the costs in a geographically even-handed manner.

3. New Jersey's theory would undermine formula apportionment. If every state were free to gerrymander its preapportionment tax base, incorporating out-of-state income while excluding the out-of-state costs incurred in generating that income, taxing authorities could seek to identify forms of business activity conducted exclusively or overwhelmingly outside the state's borders and then shape allowable deductions to disfavor the costs incurred on account of those activities. The effect would be to export the local tax burden, increasing the state's tax collections at the expense of extrastate business.

The circumstances of this case illustrate the danger. By construing its add-back provision to disallow a large class of site-specific, exclusively out-of-state costs, New Jersey has necessarily skewed to a significant degree the tax base of every affected taxpayer. This Court has never required mathematical precision in the apportionment of multistate income, and a closer case, involving a less pronounced geographical disparity, might present delicate line-drawing problems that this case does not. Contrary to New Jersey's assertion, however, that is no reason to give the states license to nullify the fair apportionment requirement by manipulating the preapportionment tax base.

B.

In form, the add-back provision is part of New Jersey's corporate net income tax. In economic reality, it operates as a New Jersey version of the federal windfall profit tax, mathematically increasing each producer's New Jersey tax liability by an "apportioned" percentage of its federal WPT liability. Viewed in that light, the add-back provision effectively levies a transactional tax that exceeds New Jersey's taxing jurisdiction.

The removal of crude oil, like the severance of coal, can be taxed directly only by the state within which it occurs. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617 (1981). Because no crude oil is removed from premises located in New Jersey, the state lacks nexus to tax the removal activity. Likewise, New Jersey may not impose a tax that is effectively measured by the value of crude oil at the time and place of removal, because that value "bears no relationship to the taxpayers' presence or activities" in New Jersey. *Id.* at 629. New Jersey should not be permitted to achieve indirectly, under the cover of an income tax, what it is forbidden to do directly.

II

A.

New Jersey's add-back provision, as construed, impermissibly discriminates against a category of exclusively out-of-state business operations. Although the provision nominally reaches WPT costs regardless of where they are incurred, they are in fact incurred only outside the state's borders. Facial neutrality is no defense under the Commerce Clause and the Equal Protection Clause when a tax classification operates, as New Jersey's does, in a geographically discriminatory manner.

B.

1. The New Jersey Supreme Court mistakenly concluded that constitutional protections are inapplicable if the disfavored business activity has no identical in-state

counterpart. When a company that operates in several states is subjected to a disproportionate tax burden in one state solely because of its business operations in another, the effect is to penalize it for crossing the taxing state's borders, thereby erecting economic obstacles to interstate trade. If every state were free, as New Jersey claims to be, to disfavor business operations that are performed exclusively outside the taxing jurisdiction, it would be only a matter of time before multistate companies would confront a balkanized confederacy of retaliatory tax regions, contrary to the central purposes of the Commerce Clause.

2. The discriminatory effect of the add-back provision provides a direct competitive advantage to non-producer independent petroleum marketers with whom the integrated companies directly compete in New Jersey. Under the state's taxing scheme, each integrated company must add back to its federal taxable income a significant portion of its out-of-state oil production costs, while its non-producer competitors are permitted to deduct in full their cost of acquiring petroleum products.

Where, as here, all members of the disfavored class are necessarily interstate operators, it is immaterial that some members of the favored class may also be interstate operators. The New Jersey scheme unlawfully exacts from a segment of interstate business more than a fair share of the local tax burden. That result is forbidden irrespective of how the resulting competitive benefits are allocated.

ARGUMENT

I. THE NEW JERSEY STATUTE, AS CONSTRUED AND APPLIED, IMPERMISSIBLY TAXES EXTRA-TERRITORIAL VALUES

It is fundamental that, "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 164 (1983), *quoting ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). In the case of a multistate company that derives its income from more than one jurisdiction, a state may tax only that portion of the company's net income that is "'reasonably attributable' to the business done there." *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942).

One way for a state to determine the "locally taxable income" of a multistate business is by means of "formal geographical or transactional accounting." *Container*, 463 U.S. at 164. But when a company's "intrastate and extra-state activities form[] part of a single unitary business," the Court has recognized that "separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 (1980); *accord Container*, 463 U.S. at 164-65.

For that reason, the Court has long permitted states to tax the net income of a multistate company under the "unitary business/formula apportionment method." *Id.* at 165. That method uses a two-step procedure for deriving locally taxable income. First, the state must determine the company's preapportionment tax base by "defining the scope of the 'unitary business'" and calculating its total net income from all sources. *Id.* Second,

the state must "then apportion[] the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." *Id.*

New Jersey uses the unitary business/formula apportionment method and applies the common three-factor apportionment formula. A corporation that does business both inside and outside New Jersey is subject under the CBT to a tax of nine percent on that portion of its "entire net income"—defined as "total net income from all sources"—that is "allocable to this State." N.J. Stat. Ann. §§ 54:10A-4(k), 54:10A-5(c) (West 1986). The state's "allocation factor" is the average of three fractions representing the in-state ratios of the taxpayer's total property, receipts, and payroll. *Id.* § 54:10A-6. New Jersey's apportionment formula can be expressed as follows:

$$\text{Entire net income} \times \frac{\left(\frac{\text{NJ property}}{\text{All property}} + \frac{\text{NJ receipts}}{\text{All receipts}} + \frac{\text{NJ payroll}}{\text{All payroll}}\right)}{3}$$

$$= \text{NJ taxable income}$$

Formula apportionment does not permit a state to reach "extraterritorial values." *Mobil*, 445 U.S. at 442; *Butler Bros. v. McColgan*, 315 U.S. at 507. On the contrary, the method is permissible only insofar as it produces at least a "'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State.'" *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 223 (1980), *quoting Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978). In the words of Justice Holmes, "[t]he purpose is not . . . to open to taxation what is not within the State," but only to estimate "the true value of the things within it." *Wallace v. Hines*, 253 U.S. 66, 69 (1920).

The Court has synthesized these territorial limitations on state taxing power in a four-pronged test, developed principally in Commerce Clause cases but embodying Due Process standards as well. *See* 1 J. Hellerstein, *State Taxation* ¶ 4.8, at 123 (1983). To pass constitutional muster, a state tax, including one that employs the unitary business/formula apportionment method, (1) must be "applied to an activity with a substantial nexus with the taxing State," (2) must be "fairly apportioned," (3) must "not discriminate against interstate commerce," and (4) must be "fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

In applying the *Complete Auto* test, the Court is particularly vigilant to the dangers posed by geographically "tailored" state taxes—including those that are facially neutral but that effectively apply "different rates for different types of business" or that "change with the nature of the corporate activity involved." *Id.* at 288 n.15. The Court has recognized that "[a]ny tailored tax of this sort creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." *Id.* Accordingly, "[a] tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." *Id.*

As applied to vertically integrated oil companies, the New Jersey tax is geographically tailored. It singles out for uniquely disadvantageous treatment a substantial cost incurred on account of a business activity—crude oil production—that is performed only outside New Jersey. In its practical operation, the tax produces precisely the "forbidden effect" of which *Complete Auto* warned, violating all four prongs of the test.

Putting to one side for a moment the question of discrimination, we address in this section the three terri-

toriality prongs of the *Complete Auto* standard: fair apportionment, nexus, and fair relationship.

A. New Jersey's Construction of its Add-Back Provision Geographically Distorts the Tax Base of Crude Oil Producers and Results in an Unfairly Apportioned State Tax

1. *Geographical Tailoring of Deductions Produces an Inherently Asymmetrical Apportionment*

The fairness of apportionment depends not only on the state's apportionment formula but also on the makeup of the preapportionment tax base to which the formula is applied. If a state defines taxable income in a manner that incorporates out-of-state values disproportionately, even the fairest apportionment formula will necessarily yield a geographically skewed and therefore improper result.

It follows that if, as here, a state imposes a tax based on net income—thereby allowing deductions from gross receipts—it cannot, consistent with constitutional limitations, tailor the allowable deductions geographically either (1) by permitting deductions for costs incurred only inside the state, or (2) by disallowing deductions for costs incurred only outside the state. Of course, the vast majority of business expenditures—such as wages, depreciation, bad debts, and interest expense—are no more likely to be incurred outside than inside any particular state. A taxing jurisdiction is free to permit or deny deductions for such geographically dispersed costs without risk of creating an inherently asymmetrical tax base.

But the circumstances here are quite different. Windfall profit tax liability is incurred solely on account of the removal of crude oil from producing premises located outside New Jersey. By defining "entire net income" to forbid a deduction for this large and distinct class of exclusively out-of-state costs, New Jersey automatically incorporates in each appellant's preapportionment tax base a disproportionate component of out-of-state values. When New Jersey applies its standard three-factor apportionment formula to this geographically unbalanced tax base, it effectively subjects to local taxation a percentage of income that is necessarily greater than can fairly be attributed to in-state business activities.

The state does not dispute the central premises of our argument. It conceded at the jurisdictional stage of this case that the WPT is a "cost" "attributable to oil production" (Motion 14),[7] that "there is no crude oil production in New Jersey" (*id.* at 21), and that appellants' WPT costs therefore "have a geographic source outside" New Jersey. *Id.* at 14. It acknowledged that the effect of denying a WPT deduction is to "augment appellants' entire net income." *Id.* at 19.

New Jersey asserts, however, that the Court should provide no remedy under the fair apportionment prong of *Complete Auto* unless appellants can demonstrate that "denial of a deduction for the WPT results in an irrational, arbitrary *amount* of their income being subjected to tax." Motion 14 (emphasis in original). Even if that were the appropriate standard, the record here would amply satisfy it. As reflected in the table appended to this brief, New Jersey, through the operation of its add-back provision, dramatically increased the amount of appellants' taxable income and state tax liability. App. A, *infra*, at 1a.[8]

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[7] "Motion" refers to the Motion to Dismiss or Affirm in No. 87-453.

[8] By denying a WPT deduction, New Jersey was able to increase the tax liability of these 13 appellants for tax year 1980 alone (when crude oil price controls remained largely in effect and WPT payments were accordingly limited) by $10.1 million, an increment of 22 percent. App. A, *infra*, at 1a. In 1981, as WPT payments accelerated following the termination of price controls, the state tax repercussions were even more striking. For just the five appellants whose 1981 tax year is at issue, denial of the WPT deduc-

More fundamentally, however, the flaw in New Jersey's scheme is qualitative, not merely quantitative. When a taxpayer complains about a particular application of an otherwise structurally sound state apportionment mechanism, it may properly be held to a high standard of proof concerning the degree of distortion. *See Container*, 463 U.S. at 170; *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 134 (1931). But where, as here, a state's mechanism is structurally defective, so that it necessarily distorts the net income base of a discrete class of substantial taxpayers, the standard is different. As the Court recognized in *Hans Rees*, a geographically tailored scheme may be invalidated at the threshold on the ground that it is "intrinsically arbitrary," without the need for individualized scrutiny of each taxpayer's particular circumstances. *Id.* at 133. *Accord Bass, Ratcliff, & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 283 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

To take a simple example of such geographical tailoring, suppose that New Jersey, instead of disallowing a deduction for WPT costs, had required each integrated oil company to double the numerator of its payroll fraction under the CBT's apportionment formula. The result in every case would be to increase artificially each company's New Jersey allocation factor, thereby necessarily imputing to the state more than its fair share of the company's multistate net income. No further inquiry is required to conclude that such a formula would be "intrinsically arbitrary" under *Hans Rees*.

Alternatively, suppose that New Jersey had excluded from the property fraction any consideration of the value of oil production property. Since there is no oil production property in New Jersey, the effect of such a rule would be to reduce the denominator of every integrated company's property fraction, thereby increasing its allocation factor and inflating its post-apportionment income subject to New Jersey taxation. One need not examine the formula's quantitative application to any particular oil company to know that it will necessarily produce a geographical imbalance in the company's taxable income.

A similar analysis should apply where, as here, the state employs a geographically benign apportionment formula but introduces an inevitable geographical bias into its definition of net income. Because each company's post-apportionment taxable income is computed by multiplying its preapportionment "entire net income" by its New Jersey "allocation factor," the impact on taxable income is the same whether the geographical tailoring occurs in the numerator or denominator of an allocation fraction or in the composition of the preapportionment tax base. In each case, the tailoring is "intrinsically arbitrary" because it creates what this Court characterized in a related context as "an *automatic* 'asymmetry'" in every affected company's post-apportionment taxable income. *Container*, 463 U.S. at 195 (emphasis in original).[9]

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tion produced an aggregate increase in New Jersey tax liability of $12.5 million, an increment of 260 percent. *Id.* The impact on some individual companies was particularly egregious. In the case of Amerada Hess, for example, disallowance of the WPT deduction raised its New Jersey tax liability for 1981 from about $860,000 to $7.6 million, an increase of 775 percent. *Id.*

The full impact of the decision below, of course, is not limited to these appellants or to these two tax years. At the jurisdictional stage, New Jersey itself represented that, just for the years 1980 through 1984, the "approximate revenues attributable to denying a deduction for the WPT to these and other producers of crude oil" totaled $88.5 million, excluding deficiency interest. Motion 11 n.8.

[9] As the Solicitor General correctly observed, "because the [New Jersey] tax liability is calculated by multiplying 'entire net income' by the apportionment fraction by the tax rate, the same percentage increases in tax liability could have been achieved by leaving the 'entire net income' base unchanged but increasing the apportionment fraction by the same percentages." U.S. Br. 23 n.24. Appendix

2. *A State's Treatment of Income Tax Deductions Is Not Immune From Constitutional Scrutiny*

The New Jersey Supreme Court ruled, in effect, that the federal Constitution imposes no restraints at all on the state's treatment of income tax deductions. J.S. App. 33a-34a. Its brief discussion of that issue suggests three possible theories.

First, the Court apparently assumed (J.S. App. 33a) that, if a state correctly determines the scope of a unitary business and applies an acceptable three-factor apportionment formula, nothing in the Constitution prevents it from defining taxable income in any way it sees fit, even if the definition necessarily produces gross geographical distortions. That view eviscerates the fair apportionment requirement. It would be pointless to insist on a geographically neutral apportionment formula if the state were free to apply it to a geographically distorted income base.

In striking down New York's geographically discriminatory tax credit in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), this Court held that "[n]othing about the apportionment process releases the State from the constitutional restraints that limit the way in which it exercises its taxing power over the income within its jurisdiction." *Id.* at 398-99. A similar principle should apply here as well. The fairness of an apportionment formula should give a state no greater license to tamper in a geographically selective manner with a taxpayer's preapportionment net income base than to adjust in a geographically discriminatory manner its post-apportionment tax liability.

B to this brief, *infra*, at 2a, tabulates for the years in issue both the actual New Jersey allocation factor for each company and the effective allocation factor that New Jersey would have had to use to accomplish the same increases in the company's tax liability without adding back WPT payments. Compare App. A, *infra*, at 1a.

Second, the New Jersey Supreme Court may have believed (*see* J.S. App. 33a-34a), as the state argued below (App. Div. Br. 21-23, 117-18), that deductions are solely a matter of legislative grace. But even if a state were free to disallow all deductions—an assumption that raises a different set of constitutional questions [10]—it would not follow that it could permit some and deny others without constitutional constraint. "While appearing to tax income by a reasonable formula of apportionment, a state can unfairly enlarge its share [of multistate income] by refusing to allow commonly permitted deductions." *Developments in the Law—Federal Limitations on State Taxation of Interstate Business*, 75 Harv. L. Rev. 953, 967 (1962). Consequently, once a state determines to allow deductions from gross receipts, it must do so on a geographically neutral basis. Were it otherwise, the fair apportionment standard could be evaded by the simple expedient of carving out deductions that effectively favor in-state or disfavor out-of-state activities.

[10] As the Solicitor General noted, "as more and more costs are disallowed, the preapportionment figure moves away from 'net income' and toward gross revenues." U.S. Br. 21 n.21. Although this Court "has not generally considered whether a State may tax a unitary business's gross receipts by multiplying company-wide receipts by ratios like that used by New Jersey (payroll, receipts, property)," the Solicitor General believes that "[a]ny such tax would create a risk of multiple taxation, because the in-State receipts are fully taxable by the State where they are received." *Id.* In his view, moreover, "the practical justification for using an apportionment formula is considerably weaker for gross receipts than for income. That justification rests to a large degree on the difficulty of identifying the State in which *profits* (the net of revenues over costs) are generated . . . ; but receipts are one of the standard elements of the three-factor apportionment fraction precisely because their location is objectively measurable with reasonable certainty." *Id.* (emphasis in original). The Court need not grapple with these questions here because, in the Solicitor General's words, "[t]hese cases involve only a problem of geographic skewing." *Id.*

Certainly a state could not, without exceeding its territorial taxing jurisdiction, single out an exclusively out-of-state business activity and require a taxpayer to double the income from that activity in computing its taxable net income. The state should have no greater latitude, under the heading of legislative grace, to deny a deduction for half of the costs incurred on account of an out-of-state activity. Halving out-of-state deductions, no less than doubling out-of-state income, distorts the preapportionment tax base, violates the fair apportionment requirement, and "project[s] the taxing power of the state plainly beyond its borders." *Nashville, Chattanooga & St. Louis Ry. v. Browning*, 310 U.S. 362, 365 (1940).

This Court in *Westinghouse* rejected a similar attempt to invoke legislative grace. New York sought to justify its geographically discriminatory tax credit on the theory that it "forgives merely a portion of the tax that New York has jurisdiction to levy" (466 U.S. at 398)—in effect, because the state can tax the whole, it should be altogether free to tax any amount less than the whole. The Court held, however, that "it is not the provision of the credit that offends [constitutional limitations], but the fact that it is allowed on an impermissible basis, *i.e.*, the percentage of a specific segment of the corporation's business that is conducted in New York." *Id.* at 406 n.12.

As in *Westinghouse*, the issue here is not whether New Jersey can grant or deny a deduction but whether it can do so "on [a geographically] impermissible basis." *Id.* Here, as in that case, the doctrine of legislative grace provides no shield for the constitutional defect in the state's taxing scheme.[11]

[11] Just a few days ago, the Court rejected yet another claim of legislative grace when it invalidated, under the Privileges and Immunities Clause, Virginia's residency requirement for admission to the bar without examination. *Supreme Court of Virginia v. Friedman*, No. 87-399 (June 20, 1988). The state argued that, because it could lawfully require all bar applicants to pass an examina-

In this Court, New Jersey advances a third, closely related justification for the state court's holding. The state acknowledges that its taxing power is subject to the "territorial constraints of the Due Process Clause" (Motion 2), and it apparently recognizes that its "net income base" must be free of "geographic bias." *Id.* at 14. But its concept of geographic bias is eccentric. Under New Jersey's theory, so long as the starting point for calculating taxable net income does not exceed the total gross receipts of a unitary enterprise, the state's treatment of deductions, no matter what their geographic source may be, "introduces no unconstitutional distortion to the net income base." *Id.* at 15. But the net income base is determined by subtracting allowable deductions from gross receipts. If the deductions are geographically unbalanced, the resulting base will be geographically distorted even if the starting point of gross receipts has been determined on a permissibly neutral basis.

The source of the state's apparent confusion is its reading of *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). The Court there held that a non-production state may include in the preapportionment tax base of an integrated oil company "income derived from the extraction of oil and gas located outside the State which is used by the [taxpayer's] refining department." *Id.* at 210. New Jersey infers from that holding that it may both include the income from out-of-state oil produc-

tion, its refusal to waive an examination for nonresidents gave rise to no constitutionally cognizable claim. Slip op. at 5-6. That argument is echoed by New Jersey's assertion here that, because the state could tax any amount up to gross receipts, its disallowance of a deduction from gross receipts is not subject to federal constitutional constraints. The Court in *Friedman* held, however, in terms that illuminate the issue here as well, that "[a] State's abstract authority to require from resident and nonresident alike that which it has chosen to demand from the nonresident alone has never been held to shield the discriminatory distinction from the reach of the Privileges and Immunities Clause." Slip op. at 7.

tion and simultaneously disregard the associated costs. Motion 14.

That view of the case would convert *Exxon* into a tax collector's bonanza, allowing each jurisdiction to tax out-of-state income unencumbered by out-of-state costs. But nothing in this Court's opinion suggests that a state may properly separate production income from associated production costs, pulling the income into the state while leaving the costs behind. On the contrary, the Court plainly assumed that unitary "costs and charges" were inseparable from unitary income. 447 U.S. at 221.

3. *Requiring Geographical Neutrality in the Definition of Net Income Is Not "Unworkable"*

The state's fallback argument, developed principally in response to the Solicitor General's brief, is that "appellants' proposed doctrine would be totally unworkable." Br. in Resp. to U.S. 7. But it is no more unworkable to insist on geographically neutral tax deductions than to require geographically fair apportionment formulas.

The Court has always recognized that "apportionment with mathematical exactness is impossible" (*Hans Rees*, 283 U.S. at 134) and that some degree of "imprecision" is constitutionally tolerable. *Moorman*, 437 U.S. at 273. It has therefore accorded the states a generous "margin of error" when they apply fundamentally even-handed apportionment principles. *Container*, 463 U.S. at 184. But states should have no greater freedom in their treatment of deductions than in their framing of apportionment formulas to adopt intrinsically unfair schemes that inevitably exaggerate the share of multistate income reasonably attributable to the taxing jurisdiction.

We acknowledge that it may be difficult to craft bright-line tests that clearly distinguish between a geographically tailored and impermissibly skewed tax scheme on the one hand and an inherently fair though tolerably imprecise scheme on the other hand. But there is nothing new

in that. The Court has long instructed that decision-making in this area "requires a case-by-case analysis" (*Westinghouse*, 466 U.S. at 403) where "the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977).

Although the decision of any case naturally has implications beyond the confines of the particular circumstances at issue, the reach of our analysis, as the Solicitor General correctly stated, "is narrowed by several inherent limitations." U.S. Br. 21.

First, our theory "applies only to costs that are properly identified as site-specific, those whose amount increases directly with the level of activity that is identifiably out-of-State." *Id.* The WPT, as a transactional tax, is a cost tied directly to an event—the removal of each barrel of crude oil—that occurs at a specific time and place and only outside New Jersey.

Second, our analysis "depends on an in-State/out-of-State comparison of the incidence of [the out-of-state] cost, so that if the State treats comparable in-State costs in the same manner, there may be no constitutional problem." U.S. Br. 22. If the disfavored class of costs includes a roughly proportional mix of those linked to in-state as well as those linked to out-of-state activities, the state's disallowance of the deduction would be presumptively even-handed and therefore not subject to the charge that it necessarily skews the tax base of every affected taxpayer.

Third, "these cases involve a cost that is incurred exclusively out-of-State, so the Court need not rule on cases involving less stark skewing." U.S. Br. 22. It may be that the principles underlying our analysis should extend as well to costs that are incurred overwhelmingly, even if not exclusively, outside the taxing state's borders. And

some cases may present close questions. But, as the Solicitor General has pointed out, the decision here can be confined to "geographic skewing that is pronounced and systemic, and not limited to particular taxpayers based on the fortuity of the locations of parts of their businesses." *Id.* The standard of "rough approximation" (*Exxon*, 447 U.S. at 223; *Moorman*, 437 U.S. at 273), which has governed the Court's deferential scrutiny of apportionment formulas, can likewise circumscribe any challenge to a state's preapportionment tax base.

Far more dangerous than requiring geographical neutrality in the definition of net income is the alternative proffered by New Jersey. Under its theory, any state would be free, so long as it taxed an amount no greater than apportioned gross receipts, to shape its tax deductions in a manner that inevitably incorporates out-of-state values disproportionately. Revenue-hungry state tax collectors cannot be expected to overlook the opportunity such a rule would provide to export to out-of-state business activities a disproportionate share of the burden of new state tax measures.

Indeed, New Jersey is not the only jurisdiction to have seized on the idea. Although Congress assumed when it enacted the tax that WPT payments "generally would be deductible under State income taxes" (H.R. Rep. No. 304, *supra*, at 9), the $78 billion in WPT liability that crude oil producers have incurred since 1980 [12] has proven to be an inviting target for some state tax authorities. Six other states—either by express statutory provision or by administrative ruling—specifically disallow an income tax deduction for WPT payments.[13] Not surprisingly, all but one of those states, like New Jersey, have no crude oil production at all; the remaining state has only negligible production.[14]

New Jersey's theory, of course, is not confined to WPT costs. The principle it espouses could spawn attempts by non-producing states to withdraw deductions for mineral severance taxes imposed by producing states, thereby increasing the non-producing states' tax revenues at the sole expense of out-of-state business activities. Nor is the theory limited to tax costs or to mineral production. If New Jersey's approach were upheld, each state could target categories of business operations conducted entirely outside its borders and attempt to shape its income tax deductions to magnify the state's share of multistate income derived from those operations. The New Jersey solution would threaten the foundations of formula apportionment by sanctioning state efforts to assign a disproportionate share of the local tax burden to out-of-state economic interests.

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[12] *Budget of the United States Government, Fiscal Year 1988, Supplement*, Table 17, at 6c-34.

[13] The states are Georgia, Iowa, Minnesota, New York, South Carolina, and Wisconsin. The manner in which each of these states treats WPT payments is summarized in Appendix C to this brief, *infra*, at 5a-10a.

[14] Only in New York is any crude oil produced, and its rate of production—both for the years in issue and currently—averages only about 2,300 barrels per day, or less than three one-hundredths of one percent of the nation's total crude oil production of approximately 8.6 million barrels per day. U.S. Department of Energy, *Petroleum Supply Annual 1986*, Vol. I, Table 9, at 31 (May 1987); U.S. Department of Energy, *Petroleum Supply Annual 1981*, Vol. I, Table 9, at 43 (July 1982); U.S. Department of Energy, *Energy Data Reports: Crude Petroleum, Petroleum Products, and Natural Gas Liquids: 1980*, Table 5, at 12 (December 1981).

Apart from the six states mentioned, during the transition year of 1980, North Dakota, a production state, imposed a ceiling of $1 million on a corporation's deduction of WPT payments. For years after 1980, the North Dakota statute permits a full deduction for WPT. *See* App. C, *infra*, at 8a-9a. In addition, the tax authorities in Kansas, another production state, recently issued assessment notices to at least two companies, asserting the position that WPT payments are not deductible for state income tax purposes. The assessment notices are subject to taxpayer protest and further administrative review.

4. *The WPT Is a Site-Specific Out-of-State Cost Not Comparable to Any In-State Cost for Which New Jersey Denies a Deduction*

New Jersey has acknowledged that the WPT is "a cost which happens to have a geographic source outside" the state. Motion 14. The Solicitor General has likewise concluded that "the windfall profit tax is site-specific in the critical respect—liability for it is as directly related to activity that takes place at a geographically identifiable place as is liability for an ordinary severance tax." U.S. Br. 24.

Under the Solicitor General's analysis, New Jersey would still be free to disallow a deduction for WPT costs without impermissibly skewing the state's preapportionment tax base if such costs were "sufficiently like another in-State outlay whose deduction is also disallowed by the State." *Id.* New Jersey itself points to no comparable "in-State outlay" for which a deduction is denied, and we know of none. In the Solicitor General's view, "the only non-deductible outlay that is (or could be) alleged to be comparable [to the WPT] is federal income tax liability." *Id.* He believes, therefore, that a "determinative question" in this case is "whether the windfall profit tax is more like an ordinary severance tax, whose subtraction New Jersey allows in calculating the 'entire net income' tax base, than it is like the federal income tax, whose subtraction New Jersey does not allow." *Id.*

We agree that the comparison is an apt one, but we think it relates more directly to whether the WPT is in fact an out-of-state cost, a point that is not disputed by New Jersey.[15] In any event, for the reasons suggested by the Solicitor General, we think that the WPT is constitutionally indistinguishable from an ordinary severance tax and fundamentally different from the federal income tax.

We agree with the Solicitor General that the WPT's operating incidence ("removal") and its measure (incremental value at the time and place of removal) are similar to those of a severance tax and unlike those of the federal income tax. U.S. Br. 25. Even with the "net income limitation," WPT liability, like severance tax liability, depends on the value of removed crude oil at the producing property, not on the actual receipt of revenues. U.S. Br. 25-26. Moreover, Congress deliberately cast the WPT as a transaction-based excise tax rather than a company-wide net income tax. U.S. Br. 26-27. The WPT thus operates, like a severance tax, as a "cost[] of earning income," not as a "payment[] out of income earned." U.S. Br. 28.

The dividing line between a severance tax and an income tax in this context is not, in our view, a difficult one to draw. A key question is this. If crude oil removed from the premises is lost in transit to the refinery, is the producer nonetheless liable for the tax? If so, the tax is a form of severance tax, imposed on account of the removal of the crude oil without regard to whether or how much income is subsequently realized. If not, the tax is something other than a severance tax—perhaps an income tax for which liability is incurred only to the extent that the producer ultimately realizes income from the removed crude oil.

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[15] A state severance tax—imposed on the severance of crude oil or other minerals from the ground—is the prototype of a site-specific, transactional tax. The federal income tax, by contrast, is the prototype of a levy on bottom-line net income derived from the taxpayer's business activities everywhere. If the WPT, like the federal income tax, were measured by company-wide net income from all operations, New Jersey's disallowance of the deduction would not result in the kind of geographically unbalanced preapportionment tax base of which we complain here. That conclusion would follow, however, not because the income tax would then qualify as an in-state outlay comparable to the out-of-state WPT, but because the WPT under these assumptions would not be an exclusively out-of-state outlay.

In the case of the WPT, the parties stipulated that, while several appellants lost barrels of crude oil after removal from the premises, none received a refund or credit for the WPT paid with respect to those barrels. J.A. 19. As the New Jersey Supreme Court correctly determined, "[t]he fact that the posted price may fall subsequent to the lifting of the oil or that some barrels may be lost following severance from the lease is irrelevant" to the producer's tax liability. J.S. App. 28a-29a.

It follows that the WPT "is a site-specific cost of business comparable to an ordinary severance tax." U.S. Br. 28. Because the WPT "is incurred only for out-of-State activities" (*id.*), and because New Jersey does not disallow a deduction for any comparable in-state cost, "there is present in these cases a substantial, constitutionally problematic geographic skewing . . . of the New Jersey corporate income tax base." U.S. Br. 23.

B. The Add-Back Provision Operates as a Tax on the Removal of Crude Oil from Out-of-State Premises, in Violation of the Nexus and Fair Relationship Standards

The "nexus" and "fair relationship" prongs of the *Complete Auto* test together require a territorial link between a taxing state and both the operating incidence and the measure of the tax. The nexus standard is a "threshold requirement." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981). It forbids a state from levying "*any* tax" (*id.*; emphasis in original) on business activities with which it lacks a "minimal connection." *Exxon*, 447 U.S. at 219; *Mobil*, 445 U.S. at 436. The fair relationship standard "imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the [state's] contact" with the taxpayer. *Commonwealth Edison*, 453 U.S. at 626 (emphasis in original).

It might seem at first blush that the nexus and fair relationship criteria are not implicated by New Jersey's tax scheme. After all, this Court's decisions make clear

that a state's connection with any part of a unitary business gives it sufficient nexus with the entire enterprise to impose a fairly apportioned tax on its net income from all sources. *Exxon*, 447 U.S. at 223-25; *Mobil*, 445 U.S. at 436-38. And the measure of a properly apportioned true net income tax seems plainly related to the privileges and protections provided by the state to a taxpayer that does substantial business there. *See Exxon*, 447 U.S. at 228.

But it is equally clear from the Court's decisions that the validity of a state tax depends, not on "the descriptive pigeon-hole into which a state court puts a tax," *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 443 (1940), but on its "practical effect" in light of "economic realities." *Complete Auto*, 430 U.S. at 279. An exaction that "produces a forbidden effect" (*id.* at 288) is no less invalid if it is imposed as part of an otherwise permissible income tax scheme. The Court "decline[s] to attach any constitutional significance to . . . formal distinctions that lack economic substance." *Westinghouse*, 466 U.S. at 405.

Although the New Jersey add-back provision is nominally part of the state's apportioned net income tax, its practical operation is indistinguishable in economic substance from a separately imposed New Jersey version of the federal windfall profit tax. The add-back provision requires a producer to increase its preapportionment CBT tax base by an amount equal to its federal WPT liability, to "apportion" a share of that amount to New Jersey, and to pay tax on that share at the CBT rate of nine percent. The resulting increased tax liability is exactly the same as it would be if New Jersey simply imposed an "apportioned" WPT of its own at a rate equal to nine percent of the federal rate.[16]

[16] Assume, for example, that a taxpayer's federal WPT liability for a particular year is $1 million and that its New Jersey allocation factor is 20 percent. Under the CBT as construed, the taxpayer must add $1 million to its preapportionment tax base, of

When the add-back provision is viewed in light of its true economic effect, unprotected by the formalistic trappings of a net income tax, it becomes apparent that the provision fails the nexus and fair relationship tests.

1. The nexus requirements for a transaction tax like the WPT are quite different from those for a net income tax. When a state taxes a corporation's transactions, as opposed to its net income, the state must have a nexus with the transactions themselves, not just with the corporation. The rule is that "a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." *Connecticut General Life Insurance Co. v. Johnson*, 303 U.S. 77, 80-81 (1938).

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which 20 percent (or $200,000) would be apportioned to New Jersey. The state would then apply its nine percent CBT rate to produce an increased tax liability of $18,000. Alternatively, if the state had simply adopted its own "apportioned" WPT at nine percent of the federal rate, the taxpayer's preapportionment New Jersey WPT liability would be equal to nine percent of the $1 million federal liability (or $90,000). New Jersey's apportioned share would be 20 percent or that amount (or $18,000). The effect is identical.

It is true, as the Solicitor General has noted (U.S. Br. 17 n.17), that the tax effect of the two provisions would be different for a taxpayer that has net operating losses prior to adding back WPT payments. In every other situation, however, the add-back provision operates, dollar-for-dollar, precisely the same as a New Jersey windfall profit tax. That New Jersey, in effect, allows an offset against its version of the windfall profit tax for net operating losses reported under the CBT does not change the fundamental character of the exaction. The circumstances here parallel those in *Westinghouse*, where New York's discriminatory tax credit was also adopted as part of a net income tax and therefore would likewise have had no effect on taxpayers in a net loss position. The Court nonetheless concluded, for purposes of constitutional analysis, that the "economic effect" of disallowing an income tax credit was "identical" to imposing a higher tax on the affected transactions. 466 U.S. at 404. That is the proper analysis here as well.

Consistent with that principle, the Court held recently that, when "the activity of wholesaling . . . [is] conducted wholly within [a particular state]," that state and "no other State has jurisdiction to tax" the gross proceeds derived from the activity. *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 107 S. Ct. 2810, 2822 (1987). Similarly, because mineral production occurs at a specific location, one state and only one state can have a nexus sufficient to tax it directly. *Commonwealth Edison*, 453 U.S. at 617. "'[T]he severance can occur in no other state' and 'no other state can tax the severance.'" *Id.*

That rule bars New Jersey from imposing a state WPT on the "removal" of a barrel of crude oil from out-of-state premises. "Removal" of a barrel of oil consists of transporting it away from the immediate vicinity of the well. Treas Reg. § 51.4996-1(d)(1). That event is indistinguishable for constitutional purposes from the "severance" of coal or other minerals. Indeed, at the time of its enactment, Congress repeatedly characterized the WPT as an "excise, or severance, tax." H.R. Conf. Rep. No. 817, *supra*, at 92; *accord* S. Rep. No. 394, *supra*, at 2, 29 154; H.R. Rep. No. 304, *supra*, at 2; *General Explanation* at 3, 26. Removal, like severance, can take place at only one location. As with severance, only the state within which the removal occurs has sufficient nexus with the activity to tax it.

2. The fair relationship requirement reinforces the nexus standard. It precludes New Jersey from imposing a tax whose measure is a percentage of the value of the crude oil produced in another state. Such a tax would not be "in 'proper proportion' to [the taxpayer's] activities within the [taxing] State" but instead would be tied improperly to its activities outside the state. *Commonwealth Edison*, 453 U.S. at 626. In such a case, "when the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may prop-

erly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce." *Id.* at 629. That was the basis of the holding in *American Trucking Ass'ns v. Scheiner*, 107 S. Ct. 2829 (1987), where the Court invalidated Pennsylvania's flat tax on truckers, in part because "the amount of . . . taxes owed by a trucker does not vary directly with miles traveled or with some other proxy for value obtained from the State." *Id.* at 2844.

As the New Jersey Supreme Court acknowledged, the measure of the WPT is the post-decontrol incremental value of each barrel of crude oil "at the point the oil was removed from the producing property." J.S. App. 6a. The increased value of crude oil at the point of its removal from the producing property bears a direct relationship to the producer's activities within the producing state. But it "bears no relationship to the [producer's] presence or activities" in New Jersey, *Commonwealth Edison*, 453 U.S. at 629, nor does it "vary directly with . . . [any] other proxy for value obtained from the State." *American Trucking Ass'ns*, 107 S. Ct. at 2844.

It is of no consequence that New Jersey's tax is "apportioned" by a three-factor formula. New Jersey is not free to impose any tax—whether apportioned or not—whose operating incidence falls on property or transactions with which the state has no nexus, or whose measure is unrelated to the taxpayer's activities in the state. Where, as here, a state lacks jurisdiction to tax an activity, it cannot acquire such jurisdiction by applying an apportionment formula, the effect of which is simply to tax the activity at a reduced rate. As in *Westinghouse*, talk of apportionment in these circumstances "serves only to obscure the issue." 466 U.S. at 398.

II. THE NEW JERSEY TAX, AS CONSTRUED AND APPLIED, UNLAWFULLY DISCRIMINATES AGAINST AN EXCLUSIVELY OUT-OF-STATE BUSINESS ACTIVITY

The Commerce Clause and the Equal Protection Clause prescribe distinct but complementary restraints on the exercise of state taxing power—"one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States." *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. at 869, 881 (1985) (footnote omitted). Each effectively prohibits the imposition of unjustifiably discriminatory tax burdens on out-of-state business. *Id.*; *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981); *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 668 (1981). New Jersey's add-back provision violates both clauses because it imposes on crude oil production activities—all of which are carried out in states other than New Jersey—a discriminatorily higher effective tax burden than that imposed on in-state business activities.

A. Though Facially Neutral, the Add-Back Provision Actually Burdens Only Out-of-State Business Operations

We begin our discrimination analysis with the fundamental principles established by this Court's decisions.

First, "no State may discriminatorily tax the products manufactured or the business operations performed in any other State." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 337 (1977). The production of crude oil is a business operation performed only outside New Jersey.

Second, that prohibition applies not only to "transactional taxes," such as the securities transfer tax in *Boston Stock Exchange*, but also to "taxes on general income." *Westinghouse*, 466 U.S. at 404. The New Jersey

CBT, like the New York franchise tax in *Westinghouse*, imposes "a tax on the income of a business from its aggregated business transactions." *Id.* "It cannot be that a State can circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate—as is the franchise tax—rather than on individual transactions." *Id.*

Third, it does not matter whether the state imposes the additional burden by applying a higher tax rate on out-of-state activities directly, by providing a tax credit for in-state activities as New York did in *Westinghouse*, 466 U.S. at 404-05, or by disallowing a deduction for costs incurred only for out-of-state activities as New Jersey has done here. In each case, "[t]he discriminatory economic effect . . . [is] identical." *Id.* at 404. As the Court held in *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 70 (1963), a state discriminates unlawfully if, while nominally applying the same tax rate to two classes of taxpayer, it "increase[s]" the "tax base" for one solely on account of an out-of-state element of its business.

Fourth, it is likewise inconsequential whether the statute is facially discriminatory or facially neutral. "[T]he Commerce Clause has a deeper meaning that may be implicated even though state provisions . . . do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory." *American Trucking Ass'ns*, 107 S. Ct. at 2839. For example, Pennsylvania impermissibly discriminated against interstate commerce when it imposed a flat tax on trucks for a privilege that, while "nominally equivalent," was actually far more valuable to in-state than to out-of-state trucks. *Id.* at 2847. Similarly, as Professor Lockhart stated in his classic treatment of the issue, "[n]aming the favored [products] generically rather than geographically cannot justify taxation which, in fact, discriminates against interstate commerce by favoring domestic [products] over those from other states." Lockhart, *State Tax Barriers to Interstate Trade*, 53 Harv. L. Rev. 1253, 1283 (1940). A tax written in neutral terms but "tailored" to fall more heavily on out-of-state business is exactly the kind that requires "careful scrutiny" to determine whether it has a "forbidden effect." *Complete Auto*, 430 U.S. at 288-89 n.15.

New Jersey itself conceded below that the "additional tax cost" borne by integrated oil companies under the CBT "arises because [those companies] produce crude oil." App. Div. Br. at 121. The New Jersey Supreme Court similarly acknowledged that "[p]laintiffs are denied a deduction because they produce crude oil and pay the W.P.T." J.S. App. 34a. But crude oil production takes place only outside New Jersey's borders. Just as a flat tax on trucks cannot be justified on the ground that the state has extended the same "nominal privilege" (*American Trucking Ass'ns*, 107 S. Ct. at 2846) to both in-state and out-of-state trucks, the denial of a WPT deduction cannot be justified on the ground that it imposes the same nominal burden on crude oil production regardless of where it occurs. If the activity can occur only outside the taxing state, the "formalism" of facial neutrality "'merely obscures the question whether the tax produces a forbidden effect.'" *Id., quoting Complete Auto*, 430 U.S. at 288.

B. The Discriminatory Treatment of Out-of-State Business Activity Impermissibly Interferes with Interstate Commerce

1. The New Jersey Supreme Court mistakenly concluded that the add-back provision is constitutionally inoffensive "because it does not favor in-state over out-of-state economic activity." J.S. App. 34a. It is true, of course, that the tax does not favor New Jersey crude oil production—there is none. In that respect, this case pre-

sents a slight twist on the questions considered in *Boston Stock Exchange* and *Westinghouse*. Those cases established that a state could not impose a heavier tax burden on out-of-state transactions than on the same transactions conducted within the state. The question here is whether a state may single out for special tax burdens a form of business activity that is conducted only in other jurisdictions.

Though the Court has never directly addressed that question, the "clear import of [its] Commerce Clause cases is that such discrimination is constitutionally impermissible." *Boston Stock Exchange*, 429 U.S. at 335. If companies that cross state lines find that they are subjected to disproportionate tax levies solely on account of their business activities elsewhere, they will have a natural economic incentive to operate in as few states as possible to minimize their total tax burden and to avoid subsidizing their competitors. The "inevitable effect is to threaten the free movement of commerce by placing a financial barrier around" each taxing jurisdiction. *American Trucking Ass'ns*, 107 S. Ct. at 2840. When "enterprise which straddles a state line is paying more than some or all of the enterprise that is of interest only to the taxing state," Powell, *State Income Taxes and the Commerce Clause*, 31 Yale L.J. 799, 801 (1922), state boundaries lose their character as "a neutral factor in economic decisionmaking" (*American Trucking Ass'ns*, 107 S. Ct. at 2840) and become obstacles to "the free trade which the [Commerce] Clause protects." *Boston Stock Exchange*, 429 U.S. at 329.

Further, if states with no mineral production could impose special tax burdens on mineral producers solely because of their out-of-state production activities, producing states would be equally free to impose retaliatory taxes designed to burden activities conducted only in nonproducing states. As the Solicitor General stated, "the ruling of the New Jersey Supreme Court increases the

likelihood that States will deny deductions for other exclusively out-of-State site-specific costs." U.S. Br. 16. n.16. The result—a web of discriminatory state tax levies—would promote precisely the sort of "economic Balkanization" that the Commerce Clause was designed to prevent. *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979).

2. Although there is no local oil production for New Jersey to favor, the CBT's discrimination does provide "a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). The integrated companies that produce oil outside New Jersey and market their products within New Jersey are denied a deduction for a substantial cost of their out-of-state production activities. By contrast, non-producer independent marketers, with whom the integrated companies compete at the retail level in New Jersey, are permitted a full deduction for their cost of goods sold. As a consequence, an integrated company bears a higher effective tax cost than does a directly competing independent marketer.

The discriminatory effect can be shown by a simple illustration. Suppose that the cost of producing a barrel of domestic crude oil before WPT is 20, that the WPT cost is 10, that refining costs are 12, that the wholesale price of gasoline is 42, that marketing costs are 2, and that the price of gasoline at the pump is 46. To permit a comparison at the retail level, assume further that the integrated company earns no profit at the production or refining levels but earns the same profit as the independent marketer at the retail level. The following table shows that New Jersey's add-back provision operates to tax an integrated company more heavily than the independent marketer with which it competes:

Producer/Marketer		*Non-Producer/Marketer*	
46	gross receipts	46	gross receipts
−42	cost of goods sold [17]	−42	cost of goods sold [17]
4	federal gross income	4	federal gross income
− 2	marketing expense deduction	− 2	marketing expense deduction
2	federal taxable income	2	federal taxable income
+10	N.J. WPT add-back	+ 0	N.J. WPT add-back (inapplicable)
12	N.J. tax base	2	N.J. tax base

Altering the assumptions to account for a profit at the production and refining stages does not negate the discriminatory effect of the add-back provision. The integrated company would still be subjected to a higher effective tax burden, per barrel of product sold in New Jersey, than its non-producer independent competitor. Its taxable income, unlike the independent's, is inflated because of the state's refusal to recognize a substantial component of the company's cost of production.

New Jersey acknowledges that non-producing independent marketers, unlike their integrated competitors, are permitted under the CBT "to deduct the WPT (as part of their cost of goods sold)." Br. in Resp. to U.S. 2. In its view, however, the discrimination presents no constitutional problem because the independents' entitle-

[17] A company's "cost of goods sold"—including the acquisition cost of finished products and costs "incidental to and necessary for production or manufacturing operations or processes" (Treas. Reg. § 1.471-11(b)(1))—is subtracted from gross receipts to determine federal gross income. Treas. Reg. § 1.61-3(a). The integrated company's cost of goods sold in the illustration includes pre-WPT production costs of 20, WPT costs of 10, and refining costs of 12, for a total of 42. The independent marketer's cost of goods sold consists of the wholesale gasoline acquisition cost of 42. (The illustration would not change if the integrated company took its WPT costs as a deduction from gross income instead of as part of its cost of goods sold. The net result would be identical.)

ment to the deduction "does not relate to the fact that they operate in-state." *Id.* In other words, according to New Jersey, the fact that some members of the favored class of independent marketers may operate in interstate commerce insulates from Commerce Clause attack the discrimination against out-of-state crude oil production.

But the Commerce Clause prohibits the imposition of a discriminatory tax burden on out-of-state "business operations," *Boston Stock Exchange*, 429 U.S. at 337, even if the burden falls only on a segment of interstate operators. In *American Trucking Ass'ns*, for example, the Court struck down Pennsylvania's discriminatory axle tax even though "*some* out-of-state carriers . . . pay the axle tax at a *lower* per-mile rate than some Pennsylvania based carriers." 107 S. Ct. at 2842 (emphasis added). Conversely, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984), the Court held that a Hawaii liquor tax exemption was "clearly discriminatory, in that it applies only to locally produced beverages, even though it does not apply to all such products." In each case, the discrimination offended the Commerce Clause even though the line that divided the two classes did not coincide precisely with the in-state/out-of-state distinction.

Under this Court's decisions, "a tax violates the Commerce Clause 'when it unfairly burdens commerce by exacting more than a just share from the interstate activity.'" *Tyler Pipe*, 107 S. Ct. at 2820, *quoting Washington Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 738 (1978). Where, as here, a state tax discriminates against a category of interstate operators solely on the basis of an extrastate feature of their businesses, it exacts more than a "just share" from a business that is necessarily interstate.

Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), on which the New Jersey Supreme Court relied

(J.S. App. 34a), is of no help to the state. The Court there upheld against Commerce Clause challenge a Maryland statute prohibiting crude oil producers and refiners from operating retail service stations within the state. That enactment, "an outgrowth of the 1973 shortage of petroleum," was designed to protect the "competitiveness of the [local] retail market" against perceived inequities in the distribution and pricing of gasoline. 437 U.S. at 121, 124. As the Solicitor General correctly noted, the Maryland case "involved a regulatory measure, not a tax measure, and New Jersey has advanced no regulatory objectives in these cases." U.S. Br. 22 n.22.

Furthermore, the power to exclude a company from doing business within a state does not imply the power, asserted by New Jersey here, to admit the company on the condition that it submit to a discriminatory tax burden that would otherwise offend either the Commerce Clause, *Western Union Telegraph Co. v. Kansas*, 216 U.S. 1, 47-48 (1910), *Pullman Co. v. Kansas*, 216 U.S. 56 (1910), or the Equal Protection Clause. *Metropolitan Life Insurance*, 470 U.S. at 875; *Western & Southern Life Insurance*, 451 U.S. at 667-68.

Finally, New Jersey cannot justify its discriminatory application of the add-back provision on the ground that "nonproducing marketers did not benefit, as did plaintiffs, from the decontrol of crude oil prices, but had to purchase their crude oil at the higher decontrolled prices." J.S. App. 34a. To the extent that an integrated company has benefited from decontrol, the benefit is reflected in its overall net income, a fair portion of which is properly subject to taxation by New Jersey under the CBT *without* the add-back provision.

WPT payments represent not the producer's but the federal treasury's share of higher crude oil prices. From the producer's standpoint, WPT liability is a burden, not a benefit. New Jersey's discriminatory attempt to tax both the increased net income *and* the WPT cost result-

ing from decontrol is not a rational way to equalize the tax treatment of producers and non-producers. On the contrary, it unjustifiably puts producers at a material economic disadvantage.

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed.

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APPENDICES

APPENDIX A

AMOUNTS AT ISSUE FOR 1980 AND 1981

	1980				1981			
Company	N.J. CBT Liability Before Add-Back of WPT Payments	N.J. CBT Liability After Add-Back of WPT Payments	Additional Tax Liability Attributable to WPT Add-Back	Percentage Increase in Tax Burden	N.J. CBT Liability Before Add-Back of WPT Payments	N.J. CBT Liability After Add-Back of WPT Payments	Additional Tax Liability Attributable to WPT Add-Back	Percentage Increase in Tax Burden
Amerada Hess	$10,852,307	$12,504,242	$ 1,651,935	15%	$ 864,208	$ 7,561,840	$ 6,697,632	775%
Atlantic Richfield	$ 1,275,921	$ 1,633,808	$ 357,887	28%	$ 477,001	$ 1,309,033	$ 832,032	174%
Chevron	$ 5,825,582	$ 6,947,422	$ 1,121,840	19%				
Cities Service	$ 1,344,049	$ 1,618,395	$ 274,346	20%	—0—	$ 912,204	$ 912,204	∞
Conoco	$ 385,665	$ 523,399	$ 137,734	36%				
Exxon	$15,314,745	$19,038,950	$ 3,724,205	24%				
Gulf	$ 638,411	$ 997,987	$ 359,576	56%	$ 112,834	$ 1,356,153	$ 1,243,319	1102%
Mobil	$ 1,711,268	$ 2,235,947	$ 524,679	31%				
Phillips	$ 170,593	$ 195,684	$ 25,091	15%				
Shell	$ 2,749,654	$ 3,509,330	$ 759,676	28%	$3,039,560	$ 5,031,746	$ 1,992,186	66%
Tenneco	$ 496,647	$ 592,949	$ 96,302	19%				
Texaco	$ 4,077,155	$ 5,064,761	$ 987,606	24%				
Union	$ 315,124	$ 384,965	$ 69,841	22%				
Total	$45,157,121	$55,247,839	$10,090,718	22%	$4,493,603	$16,170,976	$11,677,373	260%

Source: The figures in this table were derived from the complaints, assessment notices, and final determination letters contained in the record.

APPENDIX B

ACTUAL AND EFFECTIVE NEW JERSEY ALLOCATION FACTORS

	1980			1981		
Company	Actual Allocation Factor [1]	Effective Allocation Factor [2]	Percentage Increase in Allocation Factor	Actual Allocation Factor [1]	Effective Allocation Factor [2]	Percentage Increase in Allocation Factor
Amerada Hess	22.6582%	26.1072%	15%	23.3437%	204.2579%	775%
Atlantic Richfield	0.9030%	1.1563%	28%	1.0995%	3.0174%	174%
Chevron	4.2930%	5.1135%	19%			
Cities Service	3.1826%	3.8322%	20%	3.2046%	∞ [3]	∞ [3]
Conoco	1.2209%	1.6569%	36%			
Exxon	6.9553%	8.6467%	24%			
Gulf	1.2877%	2.0130%	56%	1.3564%	16.3027%	1102%
Mobil	6.4603%	8.4410%	31%			
Phillips	0.2279%	0.2614%	15%			
Shell	1.9703%	2.5147%	28%	1.8343%	3.0365%	66%
Tenneco	1.2223%	1.4593%	19%			
Texaco	3.6664%	4.5546%	24%			
Union	0.4179%	0.5105%	22%			

[Footnotes on next page.]

[1] "Actual allocation factor" refers to the New Jersey allocation factor as reported and accepted or as adjusted by the Director of the Division of Taxation. The figures are derived from the complaints, assessment notices, and final determination letters contained in the record.

[2] "Effective allocation factor" refers to the New Jersey allocation factor that would be required to yield the CBT liability actually assessed by New Jersey assuming no add-back of WPT payments. It is derived by dividing each company's assessed CBT liability by 9 percent (the CBT rate). The quotient equals the amount of the company's post-apportionment "entire net income" as determined by the Director of the Division of Taxation. That figure is then divided by the company's "entire net income" from all sources, before add-back of WPT payments, to determine the "effective allocation factor."

[3] Because Cities Service's 1981 "entire net income" before WPT add-back was a negative figure, an adjustment to its allocation factor could not, as a mathematical matter, affect its pre-add-back CBT tax liability of zero. Only by increasing the company's "entire net income" could New Jersey assess any CBT tax liability for that year.

APPENDIX C *

SUMMARY OF STATE TAX SCHEMES DENYING DEDUCTION FOR WINDFALL PROFIT TAX PAYMENTS

Georgia

The Georgia state code provides that "[e]very domestic corporation and every foreign corporation shall pay annually an income tax" on "its Georgia taxable net income." Ga. Code Ann. § 48-7-21(a) (Supp. 1987). If a corporation conducts business both within and without the state, Georgia taxes that "portion of [its] net income . . . attributable to property owned or business done within [the] state," as determined in accordance with a three-factor (property, payroll, and gross receipts) formula. § 48-7-31(d)(2).

Georgia bases its definition of "taxable net income" on the federal scheme. Under the state code, a "corporation's taxable income from property owned or from business done in [the] state shall consist of the corporation's taxable income as defined in the Internal Revenue Code of 1986, with [specified]adjustments." § 48-7-21(a). One such adjustment requires an add-back of various taxes, including "any taxes on, or measured by, net income or net profits paid or accrued within the taxable year imposed by the authority of the United States . . . to the extent such taxes are deducted in determining federal taxable income." § 48-7-21(b)(2).

Georgia tax administrators have determined that the WPT is a tax "on, or measured by, net income or net profits" and that WPT payments must therefore be added back to the federal tax base to determine "taxable net income."

* This appendix is a slightly updated version of the material included as Appendix G (pp. 85a-91a) to the Jurisdictional Statement in No. 87-453.

Iowa

Iowa taxes the "net income" of "each [domestic] corporation" and "every foreign corporation doing business in [the] state." Iowa Code Ann. § 422.33 (West 1971 & Supp. 1988). The state uses a single-factor (gross sales) formula to apportion to Iowa a share of the net income of a corporation doing business both within and without the state. § 422.33.2(b)(4). Under the state code, the "term 'net income' means the taxable income before the net operating loss deduction, as properly computed for federal income tax purposes under the Internal Revenue Code," with specified "adjustments." § 422.35.

In 1982, the state expanded its list of "adjustments," making the amendment effective retroactively to tax years beginning on or after January 1, 1981. The amendment provided that "the amount of windfall profits tax deducted under section 164(a) of the Internal Revenue Code" must be added back to federal taxable income for purposes of computing net income subject to the Iowa corporate tax. § 422.35.9.

In *Shell Oil Co. v. Bair*, 417 N.W.2d 425 (Iowa 1987), the Supreme Court of Iowa ruled that the state's add-back provision applies only "where payment . . . of the federal windfall profits tax has been taken by an oil producer as a deduction [from gross income] in arriving at net income on its federal return," and does not apply where the producer "in fact claimed the amount of the windfall profits tax as an inventory cost for federal tax purposes." *Id.* at 428, 429. The Court further held that the statute, as thus construed, does not violate the Due Process Clause, the Commerce Clause, or the Equal Protection Clause of the United States Constitution. *Id.* at 430-32.

Minnesota

Minnesota imposes an annual franchise tax measured by a corporation's "taxable income." Minn. Stat. Ann.

§ 290.02 (West Supp. 1988). In computing its Minnesota "taxable income," a corporation starts with its "federal taxable income," as defined by the Internal Revenue Code, to which it adds and from which it subtracts specified items. § 290.01(19), (19c), (19d), (22), (29). Among the items to be added to federal taxable income is "the amount of any windfall profits tax deducted under section 164 or 471 of the Internal Revenue Code." § 290.01(19c)(4).

The resulting amount, in the case of a unitary business that operates partly within and partly without the state, is then apportioned to Minnesota under a weighted three-factor formula representing the in-state ratios of sales (70 percent), property (15 percent), and payroll (15 percent). §§ 290.17(4), 290.191(2).

New York

New York imposes a franchise tax measured by a corporation's "entire net income." N.Y. Tax Law § 209.1 (McKinney 1986 & Supp. 1988). For corporations doing business both within and without New York, the state's share of multistate income is determined by multiplying the corporation's "entire net income" by a three-factor (property, payroll, and gross receipts) formula. § 210.3(a).

"The term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income . . . which the taxpayer is required to report to the United States treasury department . . . ." § 208.9. For state franchise tax purposes, however, "[e]ntire net income shall be determined without the exclusion, deduction or credit of . . . taxes on or measured by profits or income paid or accrued to the United States." § 208.9(b)(3). The New York State Tax Commission, in an "Opinion of Counsel," has ruled that the WPT is a tax on or measured by profits and that, as a consequence, WPT payments must be added back to

federal taxable income for purposes of computing the state tax base. TSB-M-82 (22) C, Corporation Tax (July 12, 1982), *reprinted in* 1 N.Y. St. & Loc. Tax Serv. (P.H.) ¶ 13,229; 1 N.Y. St. Tax Rep. (CCH) ¶ 9-909.

North Dakota

North Dakota imposes a tax on the "taxable income" of corporations doing business there, as apportioned to North Dakota by a four-factor (property, payroll, gross sales, cost of goods sold) formula. N.D. Cent. Code Ann. § 57-38 (Allen Smith 1983 & Supp. 1987). " 'Taxable income' . . . shall mean the taxable income . . . for federal income tax purposes under the United States Internal Revenue Code of 1954, as amended, plus or minus such adjustments as may be provided by this act and chapter or other provisions of law." § 57-38-01.8. In computing North Dakota taxable income, a corporation must increase federal taxable income "by the amount of any income taxes . . . to the extent that such taxes were deducted to determine federal taxable income." § 57-38-01.3.1(d).

For the initial year of the WPT's effectiveness, the state enacted a special statute governing the state tax treatment of WPT payments. It provided: "As to individuals, estates, trusts, and corporations, the crude oil windfall profit tax . . . shall be allowable as a deduction in computing taxable income for the first taxable year only, beginning on or after January 1, 1980; provided that the deduction for a corporation shall not exceed one million dollars." Former § 57-38-01.21(a), N. Dak. St. Tax Rep. [CCH] ¶ 11-018. For subsequent tax years, the state apparently has allowed taxpayers to treat WPT payments as fully deductible from the state's tax base. Moreover, because North Dakota has not treated the WPT as an "income" tax, WPT payments have not been subject to the state's add-back provision, which applies to "income taxes" or "franchise or privilege taxes measured by income." § 57-38-01.3.1(d). As a practical matter, therefore, the only limit that North Dakota has placed on the deductibility of WPT payments is the $1 million cap applicable to corporations in 1980.

South Carolina

With respect to a multistate enterprise conducting business within South Carolina, the state imposes a tax on the portion of the enterprise's "entire net income" that "reasonably represents the proportion of the trade or business carried on within [the] State." S.C. Code Ann. §§ 12-7-230, 12-7-250 (Law. Co-op. 1977 & Supp. 1987). The state uses a three-factor (property, payroll, and gross receipts) formula to derive an apportioned share of the business's "entire net income." *See* S.C. State Tax Commission Regulation 117-87.17.

In computing its "entire net income," a corporation starts with its "gross income and taxable income as determined under the Internal Revenue Code with [specified] modification[s]." § 12-7-415. The state code provides that the "deductions used in computing adjusted gross income and taxable income" for federal tax purposes must be "modified" in several respects. § 12-7-430(d). One such modification specifies that "there is no deduction for . . . any income taxes, or any taxes measured by or with respect to net income." § 12-7-430(d)(1).

In 1982, the South Carolina Attorney General, construing a similar predecessor provision, issued an opinion on the deductibility of WPT payments. Relying on South Carolina case law that all "ambiguity" must be resolved against the taxpayer, the Attorney General concluded that the "windfall profit tax is . . . a tax with respect to income" because it "focuses on specific profits" and that WPT payments therefore "may not be deducted in computing net income." 82 Op. Att'y. Gen. No. 13 (Mar. 10, 1982). Based on that opinion, the state does not allow a deduction for WPT payments.

Wisconsin

Wisconsin imposes a franchise tax on the "entire net income" of each corporation doing business within its borders. Wis. Stat. Ann. § 71.01(12) (West 1969 & Supp. 1987). If the corporation is a multistate unitary business, Wisconsin taxes an apportioned share of the enterprise's net income determined pursuant to a three-factor (property, payroll, and sales) formula. § 71.07(2).

Under the Wisconsin code, "'[n]et income' means, for corporations, 'gross income' less allowable deductions." § 71.02(1)(c). When the WPT was enacted, the state code provided that, in determining "net income," "[i]ncome, excess profits, war profits and capital stock taxes imposed by the federal government are not deductible from gross income." § 71.04(3). The state legislature, however, apparently did not believe that the WPT, as a "temporary excise tax" on crude oil production, was subject to that provision. Wisconsin Legislative Fiscal Bureau, Analysis of Amendment to Wis. Stat. § 71-04 (Apr. 23, 1981). The state therefore amended section 71.04(3) to provide specifically that "the windfall profit tax under section 4986 of the internal revenue code is not deductible from gross income." 1981 Wis. Laws ch. 20, § 1090c (July 31, 1981).

In *Mobil Oil Corp. v. Ley*, 142 Wis. 2d 108, 416 N.W.2d 680 (Ct. App. 1987), the Court of Appeals of Wisconsin rejected the taxpayer's state constitutional challenge to the non-deductibility of WPT payments. The Supreme Court of Wisconsin subsequently denied a petition to review the Court of Appeals' decision. *Mobil Oil Corp. v. Ley*, No. 86-1221 (May 3, 1988).

APPENDIX D

CHANGES TO RULE 28.1 STATEMENTS *

AMERADA HESS CORPORATION

Add

LubExpress Development Company, Inc.
LubExpress Land Company, Inc.
LubExpress Operating Company, Inc.

Delete

Esperanza Petroleum Corporation
Oasis Oil Company of Libya, Inc.

ATLANTIC RICHFIELD COMPANY

Add

ARCO Centennial Corp.
ARCO Chemical Asia Pacific, Ltd.
ARCO Chemical Canada Inc.
ARCO Chemical China, Limited
ARCO Chemical Company
ARCO Delaware Company
ARCO Chemical (Deutschland) GmbH
ARCO Chemical Espana Co.
ARCO Chemical Europe, Inc.
ARCO Chemical (Europe) Inc.
ARCO Chemical Export Sales Company
ARCO Chemical Foreign Sales Corporation
ARCO Chemical Indonesia, Inc.
ARCO Chemical Japan, Inc.

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* The complete lists of affiliated companies are set forth in Appendix I (pp. 105a-155a) to the Jurisdictional Statement in No. 87-453 and in Appendix G (pp. 70a-72a) to the Jurisdictional Statement in No. 87-464. This Appendix lists only amendments to the prior lists to make them currently accurate.

ARCO Chemical Korea, Inc.
ARCO Chemical Middle East, Inc.
ARCO Chemical New Zealand, Inc.
ARCO Chemical Overseas Services, Inc.
ARCO Chemical Pan America, Inc.
ARCO Chemical Products Europe, Inc.
ARCO Chemical (Singapore) PTE, Ltd.
ARCO Chemical Taiwan, Inc.
ARCO Chemical Technology, Inc.
ARCO Chemical Texas, Inc.
ARCO Chemical (Thailand), Limited
ARCO Chemical Trading, Inc.
ARCO Chemie Nederland, Ltd.
ARCO Chimie France Corporation
ARCO Chimie France S N C
ARCO Elastomers, Inc.
ARCO France, Inc.
ARCO Idemitsu Corporation
ARCO/JSP Company
ARCO Plastics, Inc.
ARCO Synthesis, Inc.
Chiunglong Petrochemical Co., Ltd.
EnArco Elastomers Company
EnArco Resins SpA
N.T. Development, Inc.
Nihon Oxirane Co., Ltd.
Oxirane Chemical Company
Oxirane Technology (Japan) Company
P.T. Gema Polytana Kimia
Yukong ARCO Chemical Ltd.

Delete

ABE Beverage, Inc.
Almeg Extrusion Company, Inc.
Ambler Mining Company
Anaconda Exploration New Zealand Limited
Anamet, S.A. de C.V.

ARCO Chemical IBERICA, S.A.
ARCO Oil Limited
Arpet Petroleum Limited
A/S Skaland Graftiverk
Atlantic Richfield Oil Limited
Atlantic Richfield de Mexico, S.A. de C.V.
Caribou Chaleur Bay Mines Ltd.
Caribou-Smith Mines Ltd.
Centroamerica de Cobre, S.A.
Cobre de Hercules, S.A.
Cobre de Mexico, S.A.
Cobroeel, S.A. de C.V.
Compania Minera Kappa, S.A.
Compania Minera Penaeebre, S.A.
Cupro San Luis, S.A. de C.V.
Delaware Bay Transportation Company
Dexter de Mexico, S.A.
Empresa de Comercio Exterior Mexicano, S.A. de C.V.
Ericsson
Flower Street Limited
Gravity Adjustment, Inc.
Imperial Eastman de Mexico, S.A.
Impulsora De Cobre, S.A. de C.V.
Industrias Nacobre, S.A. de C.V.
Industrias Technos, S.A. de C.V.
Kronos, Computacion y Teleprecese, S.A. de C.V.
Lavan Petroleum Co.
Lingebronce, S.A.
Manufacturera Mexicana De Partes para Automovites, S.A. de C.V.
Mayflower Mining Company
Minera Anaconda Limitada
Montero, Empresa Para La Industria Quimica
Nacional de Cobre, S.A.
P.T. Arutmin Indonesia
P.T. Elnusa Chemlink
Park City Ventures
Park Cummings Mining Company

Park-Premier Mining Company
Participaciones Mexicanas, S.A. de C.V.
Prince Consolidated Mining Company
Productos Especiales Metalicos, S.A.
Richfield U.K. Petroleum, Limited
Servicios Industriales Nacobre, S.A.
Sinclair (U.K.) Oil Company Limited
Sinclair Venezuelan Oil Company
Sociedade Anonima Marvin
Selvanmex, S.A. de C.V.
Swecomex, S.A.
Tubes Flexibles, S.A.
William Prym de Mexico, S.A.

CHEVRON U.S.A. INC./GULF OIL CORPORATION

Add

Chevron Development Company Limited
BGD Company
Chevron Chemical (FSC)
Plastigama S.A.
Compania Minera Chevron Dominicana, S.A.
Mineraloel-Additives Vertriebsgesellschaft m.b.H.
GOC Acquisition Corporation
Lost Hills Water Company
Ocean Facilities Inc.
Ocean Charters, Inc.
Chevron (U.K.) Offshore Investments Limited
Chevron Oil (TNS) Limited
Chevron Oil (TOGH) Limited
Chevron Oil (TOI) Limited
Chevron Oil (TNS) Limited
Chevron Chemical (Hong Kong) Limited
Chevron Germany Inc.
Chevron Niugini Pty. Limited
Chevron Tankers (Bermuda) Limited
Gulf Pension Fund Trustee Company Limited
Chevron Pension Fund Trustee Company Limited
575 Market Street Building Corporation

Delete

Amax Inc.
Bahama California Oil Company
Belize Chevron Oil Company
Chevron Singkarak Inc.
California Ecuador Petroleum Company
Chevron Canada Petroleum Limited
Standard Development Company Limited
A/S Hydrantanlaegget Koebenhavns Lufthavn, Kastrup
Arabian Chevron Trading Company
Caltex Mediterranean Limited
Eastern Transport Corporation
Chevron Oil Company (Ghana)
Chevron Oil Company of Equatorial Guinea
Chevron Oil Company of Ethiopia
Chevron Oil Company of Kenya
Chevron Oil Company of Liberia
Chevron Oil Company of Madagascar
Chevron Oil Company of Mauritius
Chevron Oil Company of Morocco
Chevron Oil Company of South Africa
Chevron Oil Company of South West Africa
Chevron Oil Company of Thailand
Chevron Petroleum Company of Greenland
Chevron Canada Petroleum Limited
Argentine Gulf Oil Company
Chevron International Chemicals Inc.
Crediton Enterprises, Inc.
Gulf Chemicals International, Inc.
Gulf Doric Western Corporation
Harshaw Chemical Company, The
Penrith Enterprises, Inc.
Ripon Enterprises, Inc.
Compania Comercial Chevron, S.A.
Gulf Oil North Sea Limited
Gulf Asian Investments Company Limited
Gulf Offshore Cameroon Company
Gulf Oil Company of Cameroon
Gulf Oil Germany Inc.

Plaschem International Co. (Hong King) Limited
Gulf West Cameroon Exploration Company
Transocean Gulf Oil Company
Caribbean Gulf Refining Corporation
Balinesian Gulf Oil Limited
Gulf Fujairah Petroleum Limited
New Frontiers Limited
Niugini Gulf Oil Pty. Limited
Gulf (U.K.) Offshore Investments Limited
Gaelic Oil Company Limited, The
Silvertown Lubricants Limited
Zaire Gulf Oil Company
Compania Petrolera Chevron Guatemala
Compania Petrolera Chevron Honduras
Dominion Oil Limited

CONOCO INC.*

Add

Biotech Research Laboratories Inc.
Du Pont Canada Inc.
Molecular Biosystems Inc.
Conoco Exploration Ltd.

EXXON CORPORATION

Add

BT Asia Securities Limited
F.T. Shyoji K.K.
Federated Pipe Lines Ltd.
Groupement Petrolier de la Cote D'Azur
Home Energy Company Ltd.
Intoplane Service Company Limited
K.K. Kyoei Agency
K.K. Marutaka Sekiyu
Minerals Limited

* The Seagram Company Ltd., through its wholly-owned subsidiary companies, owns approximately 23 percent of E. I du Pont de Nemours and Company common stock.

Mr. Lube Canada Inc.
158437 Canada Ltd.
158883 Canada Inc.
159129 Canada Inc.
160837 Canada Limited
P.A.C. S.A.R.L. (Pinson Allegret-Causse)
S.A.R.L. Viain
Sulbath Exploration Ltd.
Tonen Energy and Marine (Singapore) Pte. Ltd.
Tonen Properties Inc.
Tonex Company Limited
Worex S.N.C.

Delete

Abu Dhabi Company for Onshore Oil Operations
A/S Futurum
Building Products of Canada Limited
D.O.C. Dutch Offshore Consortium B.V.
Daitsu Sangyo K.K.
Eastcoast Spill Response Inc.
Groupement pour l'Etude d'un Pipeline Bordeaux Toulouse
Hankyu Ferry K.K.
K.K. Toko
Kobe Port Service Kabushiki Kaisha
Leco Inc.
Limburgsche Maatschappij voor Gasdistributie Limagas N.V.
Maatschappij voor Intercommunale Gasdistributie Intergas N.V.
Maatschappij voor Intercommunale Gasvoorziening in Oost-Brabant "OBRAGAS N.V."
Nichimo Kabushiki Kaisha
Norddeutsche Oelleitungs-gesellschaft m.b.H.
Pinpoint Retail Systems Inc.
Renown Building Materials Limited
Supertex, Inc.
305120 Alberta Ltd.
Wohnungsbaugesellschaft, Steimbke-Rodewald G.m.b.H.

MOBIL OIL CORPORATION

Add

Andrews Oil Pty. Limited
Arabian Chemical Terminals
Balgee Oil Pty. Limited
Carburanti Lubrificanti E Affini Meridionali (CLEAM S.p.a.)
Jet Aviation Saudi Arabia Company Limited
Kubler Heizol A.G.
La Centrafricaine des Petroles (PETROCA)
MARS S.p.A.—Milan Airport Refueling Service
Mobilpetro Sociedad Amonima
MOFELT—Sociedade Portuguesa De Feltros Betuminosos, S.A.
Norvac Pty. Limited
Primagaz
Red Sea Plastic Factory Company Limited
Societe Tahitienne Des Oleoduce
Tar Tankanlage Rumlang AG
Tonex Company Limited
Trinity Petroleum Services Pty. Limited

Delete

D. Muhlenbruch GmbH
D. Muhlenbruch GmbH & Co. KG
FACEL
Frome-Broken Hill Company Proprietary Limited
Futuro Enterprises (Christchurch) Ltd.
Futuro Homes (N.Z.) Ltd.
Goteborgs Branslesortering AB
Milan Airport Refueling Service
Oil Service Company of Iran (Private Company)
Poly Oil Chimie (P.O.C.)
Santa Clara Waste Water Company
Societe d'Armement Fluvial et Maritime "SOFLUMAR"
Societe d'Entreposage de Bobo-Dioulasso (S.E.B.)
Societe d'Entreposage d'Hydrocarbures de Bingo (SEHBI)

Society Des Huiles Lemanhieu
Society Francaise Stoner-Mudge
Society Industrielle des Asphaltes et Petroles de Lattaquie (Syrie) S.A.
Society Nouvelle pour l'Epuration des Huiles de Transformateurs—Septra
Total Centrafricaine de Gestion (TOCAGES)
Transalpine Finance Holdings S.A.
WSG, Warmeservice Gmbh
Wyco Pipe Line Company

PHILLIPS PETROLEUM COMPANY

Add

Biosciences Corporation of Texas (BIOTX)
Incinatrol Inc.
Phillips Petroleos Chiles S.A.
Wadley Biosciences Corporation

Delete

White River Shale Oil Corporation

SHELL OIL COMPANY

Shell Oil Company's parent corporation is now Shell Petroleum Inc., which, in turn, is owned directly and indirectly by Royal Dutch Petroleum Company (a Netherlands corporation) and The "Shell" Transport and Trading Company, p.l.c. (a United Kingdom corporation). In other respects, the earlier listing remains accurate.

TENNECO OIL COMPANY

Add

Tennessee Gas Pipeline Company (Delaware)
Tenneco Corporation (Delaware)
Vibromax SCI (France-in liquidation)
Butler (1843) Ltd. (United Kingdom)

Delete

Tenneco Corporation
Poclain S.A. France
SBG Puerto Rico, Inc. (Puerto Rico)
Ekco S.A.R.L. (France)
Tenneco Oil Company of Nigeria Unlimited (Nigeria)
Omni-Pac GmbH (Germany)
Omni-Pac S.A.R.L. (France)
Tunisian American Date Company (Tunisia)
Case Vibromax GmbH (Germany)
Case Vibromax GmbH & Co. (Germany)
Vibromax France SARL (France)
Vibromax SCI (France)
Case Poclain GmbH & Co. (Germany)
Depositas Del Norte, S.A. (Spain)
Terminales Quimicos S.A. (Spain)
Case Vibromax GmbH und Co. (Germany)
Marchon-Paragon Sulphonation (PTY) Ltd.
Buler (1943) Ltd. (United Kingdom)

TEXACO INC.

Delete

Deutsche Texaco AG

(8) (1)

Nos. 87-453 and 87-464

In The

Supreme Court of the United States

October Term, 1987

AMERADA HESS CORP., *et al.*,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC., AND TENNECO OIL CO.,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

ON APPEALS FROM THE SUPREME COURT OF NEW JERSEY

BRIEF OF APPELLEE IN RESPONSE TO THE UNITED STATES AS AMICUS CURIAE

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ON APPEALS FROM THE SUPREME COURT OF NEW JERSEY

BRIEF OF APPELLEE IN RESPONSE TO THE UNITED STATES AS AMICUS CURIAE

This brief is submitted by the State of New Jersey in response to the brief filed by the Solicitor General on behalf of the United States as *amicus curiae*.

THE QUESTION WHETHER THE NET INCOME BASE OF NEW JERSEY'S CORPORATION BUSINESS TAX IS GEOGRAPHICALLY SKEWED DOES NOT WARRANT PLENARY REVIEW.

The Solicitor General has concluded that New Jersey's denial of a deduction for the federal crude oil windfall profit tax ("WPT") in computing net income under New Jersey's corporate franchise tax presents a federal ques-

tion warranting plenary review, but the substance of the brief and its disagreement with the bulk of appellants' arguments establish the contrary. What is not at issue in these cases, according to the Solicitor General, leaves nothing warranting this Court's attention, specifically:

—The New Jersey provision denying a deduction for "taxes paid or accrued to the United States on or measured by profits or income" is neither facially discriminatory nor ill-motivated (SGb13);[1] contrary to appellants' views (J.S. 27), there is no discrimination in favor of non-producing independent marketers because those marketers' entitlement to deduct the WPT (as part of their cost of goods sold) does not relate to the fact that they operate in-state (*Ibid.*); denial of the deduction does not create an incentive to move oil production facilities into New Jersey, and there is no tax benefit to be gained by confining oil production to a single State (SGb14).

—Appellants "have very substantial presences in New Jersey . . . ." (SGb13).[2]

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[1] "SGb" refers to the brief of the Solicitor General.

[2] Shell had a manufacturing plant, a terminal facility, and owned 240 service stations in New Jersey. Cities Service had two refined product terminals, a research and technology laboratory, a refined product supply and distribution office, a lubes and speciality products office, an inspection station, an eastern regional office and a number of service stations. Exxon is a New Jersey corporation which had in New Jersey two chemical plants, a refinery, manufacturing plant, two chemical division sales offices, four chemical division corporate offices, two divisional offices, two corporate offices, an aircraft hangar and numerous gasoline stations. Atlantic Richfield had numerous gas stations in New Jersey. Union Oil had four chemical facilities in New Jersey and two auto/truck stops used in marketing its petroleum products. Mobil had a refinery in New Jersey, a corporate office, and 423 gasoline stations. Phillips Petroleum had a petrochemical division office and a terminal in New Jersey. Gulf had two terminals and a marketing office in New

(Continued on following page)

—Denial of a deduction for the WPT does not violate the nexus requirements of the Due Process or Commerce Clauses because, contrary to appellants, the subject matter of the tax remains some portion of overall company-wide income, and not the out-of-state activity of oil production (SGb17 and n.17).

—Because appellants' businesses are unitary, despite denial of a deduction for the WPT, the measure of New Jersey's corporation business tax may nevertheless be fairly related to state benefits (SGb17 to 18).

Having conceded the above, the Solicitor General is relegated to suggesting that New Jersey's denial of a deduction for the WPT may be constitutionally infirm only because it may violate the fair apportionment requirement of the Commerce Clause or may discriminate against interstate commerce in some fashion not plainly articulated in the Court's prior decisions (SGb15, 18).

The present record will not support an argument of unfair apportionment. As the Solicitor General points out, the Court has generally upheld varying state tax apportionment formulas against claims of double taxation, taxation of too much income, and inconsistency with other States' formulas (SGb8 to 9). *See Moorman Mfg. Co. v. Bair*, 437 *U.S.* 267 (1978). To establish that an apportionment formula operates unconstitutionally, a taxpayer must show that the amount of income apportioned to the State is "out of all appropriate proportion to the business transacted" there. *Container Corp. v. Franchise Tax Board*,

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(Continued from previous page)

Jersey as well as various gasoline stations. Chevron had a refinery in New Jersey, a lube oil bulk plant and owned (but did not operate) 77 retail outlets. Conoco had two sales offices, two transportation facilities, one antifreeze blending plant, and nine refined products storage facilities in New Jersey. (Pltf. Jt. App. 1133a to 1137a).

463 *U.S.* 159, 180-181 (1983). Nothing in this record suggests that the oil companies' profits attributable to New Jersey after denial of a deduction for the WPT are "out of all appropriate proportion to the business transacted" within the State. While the percentage increases in tax liability resulting from denial of a deduction for the WPT may appear large (*see* SGb23, n.24), appellants' very substantial presences in New Jersey (*see* n.2 above), indicate that their New Jersey activities contributed substantially to their overall net income. Due to the impossibility of determining precisely where the net profits of a unitary business are earned (SGb21, n.21), the increases in appellants' New Jersey tax liabilities attributable to denying a deduction for the WPT cannot be shown to be excessive. *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 *U.S.* 271, 283 (1924); *Moorman Mfg. Co. v. Bair*, 437 *U.S.* at 272-274, 276. Accordingly, the constitutional requirement of fair apportionment is satisfied.

It is no more likely that denial of a deduction for the WPT skews the net income base of New Jersey's corporation business tax in such a way as to discriminate against out-of-state activities. Again, there is a problem of proof. The Solicitor General suggests that denying a deduction for the WPT skews the net income base because New Jersey "has asymmetrically included receipts without allowing deductions for associated costs" (SGb16), but there is no proof in this record as to the amount of receipts from sales of crude oil at the wellhead which were included in appellants' gross receipts for federal income tax purposes. What the record shows is that the majority of the appellants[3] sold at the wellhead between 0% and

[3] In the New Jersey courts, the so-called "Atlantic plaintiffs" included the 11 appellants, other than Amerada Hess, listed in the Jurisdictional Statement in No. 87-453, at ii, plus Diamond Shamrock.

53% of their total barrels of crude oil and exchanged between 0% and 84% of their oil. (App. 29a).[4] Nothing in the record translates these percentages into receipts for federal income tax purposes and nothing indicates whether the barrels of oil exchanged were exchanged at the wellhead or further downstream or whether the exchanges resulted in gross receipts for federal income tax purposes.[5] If there were no, or proportionately minimal, receipts from wellhead sales or exchanges included in gross receipts for federal income tax purposes, there were no or minimal such receipts in New Jersey net income, which is based on federal taxable income. *N.J.S.A.* 54:10A-4(k) (A.App.1a).[6] Denying a so-called site-specific deduction creates no distortion if there are no, or relatively minimal, site-specific receipts. Indeed, allowing a deduction for a site-specific cost where there are no corresponding site-specific receipts would result in a skewing of the tax base to the benefit of out-of-state oil production rather than its detriment. Even if some wellhead receipts entered into the tax base, the record does not establish the amount, and thus geographic skewing cannot be established. Although

[4] The data on wellhead sales and exchanges is detailed at Pltf. Jt. App. 1141a and shows that one appellant had no sales at the wellhead, eight sold between 2% and 10% of their production and that acquired from third parties, one sold approximately 12%, and one approximately 53%.

[5] The balance of appellants' crude oil production and the crude oil acquired in exchange transactions from other producers were transferred from their exploration/production divisions downstream into their refining divisions (Pltf. Jt. App. 1140a) and *see Exxon Corp. v. Department of Revenue*, 447 *U.S.* 207, 212, 225-226 (1980). Since these downstream transfers did not involve third parties but were made from one corporate division to another, they did not generate gross receipts or revenue for federal income tax purposes. 26 *C.F.R.* § 1.61-3 (a); see SGb25.

[6] "A.App." refers to the appendix to the Motion ot Dismiss or Affirm.

wellhead value may have been reflected in ultimate gross receipts realized when appellants sold their refined crude oil or petrochemical products, those downstream receipts were not wellhead receipts and accordingly were not site-specific income. *See Shell Oil Co. v. Iowa Department of Revenue*, No. 87-984, brief for the United States as *amicus curiae* at 2 to 3, 5, n.1, 6.

The Solicitor General sets forth additional reasons for not granting plenary review.

1. Similar skewing was found acceptable in *Container Corp. v. Franchise Tax Board,* (SGb16), where the taxpayer claimed that the three-factor apportionment formula, when applied to its worldwide unitary net income, systematically apportioned too much income to California because its foreign subsidiaries were significantly more profitable than its domestic operations and foreign wages were significantly lower than domestic wages. 463 *U.S.* at 181-182. Just as the Solicitor General suggests is the case here (SGb18 to 19), taxpayers doing business exclusively in California benefitted from a free ride or reduced fare by comparison to those doing business in California and abroad, and the greater Container's foreign activities, the greater was the distortion to the California net income base. The answer here, as in *Container* (463 *U.S.* at 182), is that, since appellants are unitary businesses, it is impossible to determine the geographic source of their net income or for that matter their gross receipts and thus impossible here to prove the existence of site-specific receipts.[7]

[7] While a receipt may for the sake of convenience be attributed to the State in which the sale is made, in fact, an integrated producer's receipts from the sale of crude oil at the wellhead relate substantially to its exploration, refining, manufacturing, and marketing activities in a number of States.

(Continued on following page)

2. Acceptance of appellants' position could create serious practical problems (SGb20). A few examples should make clear that appellants' proposed doctrine would be totally unworkable and that the practical problems need not be explored on plenary review.

Depletion, like the WPT, is a so-called site-specific cost incurred by the mineral extraction industry. For federal income tax purposes, there are two kinds of depletion—cost and percentage. Cost depletion, which is conceptually analogous to depreciation, permits a yearly, ratable deduction for the cost basis of a mine or well to permit the recovery over time of a producer's capital costs. *Internal Revenue Code* ("*IRC*") §§ 611 and 612. Percentage depletion is not limited to the cost basis of the mine or well but rather is computed at a specified percentage of gross income from mining. *IRC* §§ 613 and

(Continued from previous page)

The Solicitor General's suggestion (SGb18) that *Westinghouse Electric Corp. v. Tully,* 466 *U.S.* 388 (1984), presented the same kind of skewing is not accurate. The tax break in *Westinghouse* increased as the *same activity* was shifted into the taxing State. Here, as the Solicitor General notes (SGb14), there is no incentive to move crude oil production into New Jersey. The fact that the tax climate in New Jersey may be less favorable than in some other State for the oil and gas production industry does not establish discrimination of the kind found in *Westinghouse*.

Nor is it accurate to equate the denial of a deduction for an out-of-state cost with the doubling of revenues received out-of-state (SGb18). A tax like New Jersey's, which is based on federal taxable income, could not be considered a net income tax if receipts were doubled. The base would no longer be net income, and unfair apportionment would be clear. Denial of a deduction in arriving at net income, however, does not destroy the net income character of the net income base because there is no single, constitutionally mandated definition of net income. *See* SGb19 to 20; *Moorman Mfg. Co. v. Bair,* 437 *U.S.* at 278-279; *Atlantic Coastline R. Co. v. Daughton,* 262 *U.S.* 413, 422, n.6 (1923).

613A. In 1975, Congress eliminated the deduction for percentage depletion in respect of most oil and gas producers, including those like appellants which refine or retail oil. *Pub.L. No.* 94-12, 94th Cong., 1st Sess., § 501(a), 89 *Stat.* 26, 47, *IRC* § 613A(d)(2) and (4). Percentage depletion continues to apply at the federal level for numerous other minerals. *IRC* § 613(b). Although a majority of the States follow the federal income tax treatment of depletion, many have their own rules. *See* generally, 1 *Multistate Corp. Income Tax Guide* (CCH) ¶ 89. Minnesota, Mississippi, Tennessee, and Wisconsin, for instance, limit all depletion to cost. *Id.* at ¶ 3208.39, ¶ 3258.17, ¶ 4158.15, and ¶ 4508.37. In each case the excess of federal percentage depletion over cost depletion must be added back to arrive at the State's net income tax base. To the extent that minerals eligible for percentage depletion under federal law are not found in these States, acceptance of appellants' position would raise the question whether denial of a deduction for percentage depletion unconstitutionally skews the net income base. On the other hand, Alabama, Louisiana and Oklahoma, which all have substantial quantities of oil production,[8] permit percentage depletion for oil and gas. *Id.* at ¶ 2058.28, ¶ 2958.47 and .73, ¶ 3858.06. Acceptance of appellants' position would raise the question whether these States are discriminating in favor of in-state oil producing activities by allowing a depletion deduction in excess of cost for minerals within their borders, while limiting the depletion deduction to cost or a lower rate of percentage depletion for out-of-state minerals.

Similar questions could be raised with respect to many States' denial of a deduction for income taxes paid to other States. *See* 1 *Multistate Corp. Income Tax Guide*

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[8] American Petroleum Institute, *Basic Petroleum Data Book, Petroleum Industry Statistics,* Vol. VIII, No. 1, Jan. 1988, Sec. IV, Table 4c.

¶ 97. For a unitary business conducting most of its operations in State A with only minimal nexus and minimal sales in the taxing State B the income tax of State A is arguably localized in that State. Must State A allow a deduction for excise taxes imposed by State B on marijuana if State A has no marijuana within its borders, or expenses of operating the gaming tables at a casino in State B if casino gambling is illegal in State A? Must New Jersey, for that matter, amend its Corporation Business Tax Act to provide that the WPT is deductible when the existing provision is facially unobjectionable, singles out no federal tax for special treatment, and applies to the WPT simply because the latter is a tax "on or measured by profits or income"?

The Solicitor General doubts that "interest payments on an integrated company's debts should be considered site-specific" (SGb21), but would that be so with respect to mortgage interest on a particular parcel of out-of-state property? How could the doctrine be limited to out-of-state costs which are treated differently if incurred in-state? A copper producer denied a deduction for out-of-state copper severance taxes (SGb22) would suffer the same alleged distortion to its net income base as these appellants, and the fact that the taxing State also denied a deduction for coal severance taxes and had coal mines within its borders would not cure the distortion for that particular taxpayer. The Solicitor General suggests that "a State where significant oil production occurs could deny deductions for specified oil production costs . . . ." (*Ibid.*). Is this Court to be called on to decide whether a State has a sufficiently large quantity of crude oil production to permit it to deny a deduction for crude oil production costs? Appellants presumably believe that New York's crude oil production of 853,000 barrels in 1986 (*Basic Petroleum Data Book,* Sec. IV, Table 4c) is not sufficient to permit it to deny a deduction for the WPT.

Cf. App. 88a. Was North Dakota's 1980 crude oil production of 40,337,000 barrels sufficient to entitle it to limit the WPT deduction in that year? *See* App. 88a to 89a. Could Florida with 9,383,000 barrels of crude oil in 1986 deny a deduction for the WPT, or Pennsylvania with 3,783,000 barrels? *Ibid.* What if a State had proved reserves but had not yet begun production?

The Solicitor General's suggestion that the doctrine would apply only where the geographic skewing was "of significant magnitude" and "obvious" is fraught with the same uncertainties. How large would the skewing have to be to violate the Constitution? Has the WPT deduction declined to such an extent due to falling crude oil prices (*see* Mot. to Aff. at 10 to 11 and n.8) that it is no longer of constitutional magnitude? Would the discrepancy between percentage and cost depletion be sufficiently small in some cases to be constitutionally acceptable? Is the Court's appellate docket to include cases questioning whether the alleged skewing is sufficiently large to be unconstitutional?[9]

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[9] The Solicitor General argues that, because the WPT resembles a severance tax which New Jersey allows as a deduction, the net income base may be impermissibly skewed (SGb23 to 28), but the mere fact that New Jersey allows a deduction for some so-called out-of-state costs, e.g., severance taxes, and denies a deduction for another, e.g. the WPT, does not, standing alone, present a constitutional problem because no in-state activity is necessarily favored by that dichotomy. If a State were required to treat all comparable out-of-state costs identically, no State could follow the federal treatment of depletion (percentage depletion for hard minerals and cost for oil and gas) if the minerals were out-of-state. While explaining why the WPT is not identical to the federal income tax, the Solicitor General does not explain that the WPT is also unlike a typical severance tax. Although there are some exceptions, the large majority of state severance taxes do not permit deductions from gross proceeds or value in arriving at the tax base. See 2 *State*

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Added to the (1) lack of evidence suggesting either unfair apportionment or geographic skewing, (2) the Court's treatment of similar in-state/out-of-state effects (SGb14,n.14) in *Container*, and (3) the enormous practical difficulties of applying the proposed doctrine, are the considerations set forth in the Motion to Affirm:

—Due to the varying provisions in state tax laws and the variety of costs and expenses which those laws allow or disallow, a decision here could not set forth an unvarying constitutional rule for the future.

—The WPT is to start phasing out in January 1991 (*IRC* § 4990(c)(3)) if not sooner repealed,[10] and worldwide crude oil prices have dropped to the point where there is little incentive for the States to deny a deduction for the WPT.

(Continued from previous page)

Tax Guide (CCH) ¶¶ 45,200 to 45,955. The WPT is invariably a net amount—the removal price (sales price or posted price) less the adjusted base price (controlled price in the particular field), adjusted for inflation and adjusted by the incremental state severance taxes paid on the windfall profit. *IRC* §§ 4988 (a), 4989(a) and (b), 4996(c). Moreover, the taxable windfall profit cannot exceed 90% of the net income per barrel, and in computing net income per barrel, virtually all economic costs are deductible. *IRC* § 4988(b); 26 *C.F.R.* § 1.613-5(a). In short, the WPT is a unique tax, insufficiently analogous to a typical severance tax to establish that New Jersey is discriminating against interstate commerce by treating the WPT and severance taxes differently, and the Solicitor General's implications to the contrary exhibit a basic misunderstanding of how the WPT operates.

[10] On February 23, 1988, Senator Domenici introduced S.2096, which, among other things, would repeal the WPT. 100th Cong., 2d Sess., 134 *Cong. Rec.* S1421 (Feb. 23, 1988); *see* Tax Analysts, *Tax Notes*, Feb. 29, 1988. The President has recommended repeal of the tax. "President's 1988 Legislative & Administrative Message to Congress," *Tax Notes*, Feb. 1, 1988.

Finally, the Solicitor General is unable to conclude whether denying a deduction for the WPT is or is not constitutional (SGb24). Such uncertainty, along with the problems of proof set forth above and the inconclusiveness of any rule which the Court might announce, demonstrate conclusively that these cases are not appropriate for plenary review.

CONCLUSION

For the foregoing reasons, probable jurisdiction should not be noted.

Respectfully submitted,

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QUESTION PRESENTED

Whether New Jersey is constitutionally required to allow a state tax deduction for the federal windfall profit tax when there is no dispute that New Jersey can tax its share of an integrated oil company's pretax unitary net income.

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In The

Supreme Court of the United States

October Term, 1988

No. 87-453

AMERADA HESS CORPORATION, et al.,

Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

No. 87-464

TEXACO INC. and TENNECO OIL COMPANY,

Appellants,

v.

DIRECTOR, DIVISION OF TAXATION, NEW JERSEY DEPARTMENT OF THE TREASURY,

Appellee.

On Appeals from the Supreme Court of New Jersey

BRIEF FOR APPELLEE

STATEMENT

Since 1958 the State of New Jersey has imposed an income-based franchise tax measured essentially by federal taxable income with certain adjustments. One of the adjustments in the 1958 legislation, which has not been changed, is the denial of a deduction for federal taxes "on or measured by profits or income." This provision is routinely applied to deny a deduction for the federal income tax and the federal minimum tax.[1] In 1980 Congress enacted the Federal Crude Oil Windfall Profit Tax Act of 1980, Pub.L. 96-223, 94 Stat. 229, 26 U.S.C. § 4986 *et seq.* (hereafter "IRC" §§ 4986 *et seq.*) to tax some of the windfall profits that oil producers were expected to receive from the federal government's decontrol of oil prices. In 1982 the New Jersey Division of Taxation determined that the windfall profit tax was a federal tax "on or measured by profits or income" and accordingly advised the appellants and other companies that they could not deduct the federal tax.

A. New Jersey Corporation Business Tax

During the years before the Court (1980 and 1981) the New Jersey corporation business tax (hereafter "CBT") was measured by the sum of a tax on net worth and a tax on net income. N.J. Stat. Ann. § 54:10A-5 (West 1986) (hereafter "N.J.S.A.") (J.S. App. 94a to 95a). (The net worth measure was subsequently repealed.

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[1] The parties stipulated that the provision at issue is applied to both the federal corporate income tax and the federal minimum tax on tax preference items (J.A. 23). The New Jersey Tax Court has similarly construed the tax disallowance provision. *Texaco Inc. v. Taxation Div. Director,* 4 N.J. Tax 63 (N.J. Tax Ct. 1982). Appellants are thus incorrect in asserting that the tax disallowance provision was dormant prior to its application to the windfall profit tax (*cf.* App. B9 n.5).

1985 N.J.L. c.55). The income measure is based upon "entire net income"[2] defined as federal taxable income before the net operating loss deduction and special deductions, without certain deductions allowed under the federal income tax. N.J.S.A. 54:10A4(k).[3] The provision which is at issue here states that, "Entire net income shall be determined without the exclusion, deduction or credit of: . . . taxes paid or accrued to the United States on or measured by profits or income . . ." N.J.S.A. 54:10A-4(k)(2)(C) (J.S. App. 94a).

Once "entire net income" is determined under the CBT, the standard three-factor apportionment formula is applied to determine what portion of a multistate corporation's taxable income is derived from New Jersey activities and is subject to new Jersey's 9% tax. N.J.S.A. 54:10A-6; N.J.S.A. 54:10A-5(c) (J.S. App. 94a).

B. Windfall Profit Tax

The windfall profit tax (hereafter "WPT") came into being in 1980 as part of the Administration's program to decontrol crude oil prices because it was expected that decontrol would increase the revenues of oil producers by $14 or more per barrel and that a portion of the additional revenues would not "be taxed through the existing corporate income tax." Cong. Budget Office, *The Windfall Profits Tax: A Comparative Analysis of Two Bills* 1, 3 (Nov. 3, 1979) (hereafter "*CBO Analysis*"); H.R. Rep. No. 96-304, 96th Cong., 1st Sess. 5, 6 (1979). The WPT is imposed, not on the removal of crude oil (*cf.* App. B3),

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[2] Under the CBT, no income is specifically allocated to a particular situs. N.J.S.A. 54:10A-5(c); N.J.S.A. 54:10A-6, N.J.S.A. 54:10A-4(k) (J.S. App. 94a to 97a).

[3] The relevant portion of N.J.S.A. 54:10A-4(k) is reproduced in the appendix to the Motion to Affirm in No. 87-453.

but on the windfall profit from taxable crude oil removed during each calendar quarter. IRC § 4986(a); IRC § 4996(b)(7). The windfall profit per barrel is the difference between the removal price and the adjusted base price plus severance tax adjustment, IRC § 4988(a), and corresponds, generally, to the difference between the current market price and the price of the oil in question in 1979 just prior to decontrol. *See United States v. Ptasynski*, 462 U.S. 74, 76, 77 n.3 (1983).[4] Under IRC § 4996(f) "[T]he Secretary may adjust the removal price to reflect clearly the fair market value of oil removed." For large amounts of crude oil, integrated companies construct a removal price based on the value of the oil at distant refineries in New Jersey and elsewhere.[5]

The WPT is a percentage of the windfall profit, ranging from 70% for Tier 1 oil removed by an integrated company to 20% on newly discovered oil during 1988 and 15% thereafter. IRC § 4987; IRC § 4992(b); IRC § 613A(d)(2).

Congress' intent to tax actual profits resulting from decontrol by means of a tax resembling an income tax is

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[4] For Tier 1 oil the base price is the May 1979 ceiling price for new or upper tier oil reduced by 21 cents. *IRC* § 4989(c). For Tiers 2 and 3, the base price is essentially $15.20 and $16.55, respectively, adjusted for the grade, quality, and location of the oil. Staff of Jt. Comm. on Taxation, *General Explanation of the Crude Oil Windfall Profit Tax Act of 1980*, reprinted in 3 Tax Management Primary Sources (BNA) Current Developments, Aug. 26, 1981, at PS123, PS124.

[5] U.S. General Accounting Office, *Report to the Honorable Bill Nelson, U.S. House of Representatives, Response to Questions About the Windfall Profit Tax on Alaskan North Slope Crude Oil*, App. I at 5, 10, 12-14, 20, 28-32 (December, 1984) (hereafter "*GAO Report*").

best demonstrated by the net income limitation, IRC § 4988(b) (hereafter "NIL"), which prevents the windfall profit per barrel from exceeding 90% of the net income per barrel. Like the computation of an income tax, the NIL computation is made at the end of a taxable year, not at the time of removal (*cf.* App. B 35), and in arriving at net income for a producing property, most production costs, other than the WPT, and many indirect costs are allowed as deductions. *Id.* The NIL substantially reduced many of the companies' WPT liabilities during the years at issue (J.A. 20 to 21).

Although Congress made the WPT deductible for federal income tax purposes, IRC § 164(a)(5), it did not preempt the states from denying a deduction for the WPT. The only Congressional reference to the state income tax treatment of the WPT appears in the tax writing committees' revenue estimates. The House Ways and Means Committee Report states that, as the WPT would "generally" be deductible for state income tax purposes, taxpayers' federal income deductions for state income taxes would be concomitantly reduced. H.R. Rep. No. 96-304 at 9. The Senate Finance Committee Report assumes that the WPT would reduce "deductible state income taxes." S. Rep. No. 96-394, 96th Cong., 1st Sess., 9 (1979). While both of these statements are true, because many states do allow a tax deduction for the WPT, there is no indication in the statute or elsewhere that Congress intended to preempt state tax laws that do not allow a deduction for the WPT.

Due to the drop in world oil prices, WPT revenues have declined significantly since 1981[6] and on August 3, 1988, Congress passed and sent to the President the Omnibus Trade and Competitive Act of 1988, H.R. 4848, § 1941, 100th Cong., 2d Sess., 134 Cong. Rec. S10737 (August 3, 1988), which repeals the WPT.

C. Appellants

The appellants are vertically integrated oil companies engaged in the exploration, production, refining, transportation, distribution, manufacture, and marketing of petroleum and petroleum products (J.A. 11).[7] Although they currently have no oil production in New Jersey (J.A. 12),[8] they have a very substantial presence in New Jersey, including, collectively, refineries, manufacturing plants, laboratories, chemical plants, offices, terminals, storage facilities, transportation facilities, and gasoline stations (J.A. 12 to 15). Exxon is a New Jersey corporation (J.A. 13). The companies both produce and purchase domestic crude oil, and once their own crude production is commingled with barrels of crude oil acquired from third parties, they have no records segregating produced from purchased barrels (J.A. 18). Most of the companies

[6] According to the United States Treasury Department, Office of Tax Analysis, WPT receipts from private parties declined from a high of $12.9 billion in fiscal 1981 to $3.1 billion in 1985, and for the period 1986-1988, the Department estimated that a total of approximately $2 billion was collected.

[7] The Stipulation of Facts in the New Jersey Tax Court (J.A. 9 to 25) covers ten of the appellants. There is no indication that the facts applicable to the remaining three companies differ materially from those which were stipulated.

[8] But see footnote 28 at 41-42 below discussing the efforts of a Texas drilling company to obtain leases near the town of Readington, New Jersey.

sell at the wellhead some small portion of the domestic crude oil which they produce and acquire from third parties, but there is nothing in the record indicating their gross receipts for federal income tax purposes derived from sales of crude oil at the wellhead (J.A. 18 to 19). Generally the substantial majority of their crude oil production and the crude acquired from third parties is transferred from their exploration/production divisions downstream into their refining divisions (J.A. 18). Since these downstream transfers are made from one corporate division to another, they do not generate income for federal income tax purposes. Treas. Reg. § 1.61-3(a).

D. Assessments and Proceedings Below

On their federal income tax returns, the companies either deducted the WPT as a tax expense under IRC § 164(a)(5) or deducted it as an ordinary and necessary business expense under IRC § 162 (*see* App. B8 and Appendix A to this brief at 3a[9]) or included the WPT as part of their cost of goods sold, which was deducted from their sales to arrive at gross profit under IRC § 471. In computing their New Jersey CBT liabilities, they took the position that the WPT is not a tax "on or measured by profits or income" and therefore claimed a deduction for the tax on their New Jersey returns.

Relying in part on the State of New York's disallowance of a deduction for the WPT under virtually identical

[9]Appendix A is drawn from the federal income tax and New Jersey CBT returns of one of the companies for the years at issue, with the name omitted, three zeros dropped from the numbers, and the numbers rounded to the nearest $100,000. As shown at 3a, appellant X deducted the WPT as a tax expense on line 17 of its federal return.

statutory language,[10] the New Jersey Division of Taxation determined that the WPT is a tax "on or measured by profits" within the meaning of the tax disallowance provision in the New Jersey CBT Act. Having failed to obtain relief at the administrative level, the companies filed complaints in the Tax Court of New Jersey.

The New Jersey Tax Court concluded that the WPT is a tax "on or measured by profits or income" within the meaning of the tax disallowance provision and rejected the companies' constitutional claims (J.S. App. 47a to 48a).

The Appellate Division of the Superior Court of New Jersey reversed the Tax Court, reasoning that the purpose of the tax disallowance provision is to preserve the same tax base under the CBT as the base upon which the federal income tax is imposed and that the CBT should not deny deductions for what the court considered legitimate business expenses (J.S. App. 41a).

The Supreme Court of New Jersey reversed the Appellate Division and found that the base and measure of the WPT fit within ordinary concepts of "income" and "profits." The court noted the distinctive language in the preliminary definition of entire net income in N.J.S.A. 54:10A-4(k) (*see* Motion to Affirm, App. 1a to 2a), which is referenced to federal income tax concepts, and the language in the tax disallowance provision using the broader, general words "income" and "profits" (J.S. App. 13a to 14a).

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[10] Opinion of Counsel, *Deductibility of Federal Windfall Profits Tax Under Article 9-A*, 1 [N.Y.] St. Tax Rep. (CCH) ¶ 9-909 (May 28, 1982).

The court rejected the companies' arguments under the Due Process and Commerce Clauses because, in its view, New Jersey is not adding out-of-state income to the base but, rather, is denying a deduction in arriving at the net income of the companies' unitary businessses, and denial of the deduction is neither triggered by the interstate nature of the companies' businesses nor favors in-state activities (J.S. App. 33a to 34a). The Equal Protection Clause is not violated, according to the court, because oil producers that have benefitted from the lifting of crude oil price controls and for that reason pay the WPT are the persons denied the deduction under the New Jersey CBT (*id.*). Finally, the New Jersey Supreme Court rejected the companies' Supremacy Clause argument on the ground that there is no evidence that Congress intended to preclude the states from denying a deduction for the WPT (*id.*).

SUMMARY OF ARGUMENT

This is an attempt by integrated oil companies to exempt from the New Jersey CBT a portion of their unitary net income equal to the WPT. The fact that the WPT Act segregates and defines for federal taxation what Congress deemed to be a discrete portion of the companies' profits does not mandate that New Jersey follow suit and withdraw that amount from the companies' unitary stream of income. The states are not bound by Congress' adoption of a form of separate accounting in the federal tax laws and may reject such accounting in favor of formulary apportionment. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 184-193 (1983).

There is no dispute that these vertically integregated oil companies are unitary businesses. Thus, under *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207 (1980), New Jersey may impose its CBT on its share of the companies' unitary net income, including income attributable in some degree to crude oil production activities outside New Jersey. The companies do not dispute this conclusion (App. B3).

During the years at issue (1980 and 1981) the companies' unitary net income included not only a normal profit attributable in some measure to crude oil production outside New Jersey but also a "decontrol element" or "windfall profit" produced when, beginning in 1979, domestic oil prices were decontrolled. Absent enactment of the WPT in 1980, it is clear that under *Exxon v. Wisconsin* New Jersey could tax this unitary net income including the windfall profit or decontrol element, and the companies do not dispute this fact.

Enactment of the WPT does not alter New Jersey's ability to tax the companies' unitary net income including the entire decontrol element. Their income equal to their WPT payments is as much a part of their unitary stream of income as (1) their so-called crude oil production income held subject to an apportioned state tax in *Exxon v. Wisconsin* and (2) the portion of the windfall profit remaining after payment of the WPT, which the companies tacitly concede New Jersey may tax.

It is irrelevant that the WPT may be a "real economic cost," a "cost . . . of earning income," or a cost paid "out of income" (U.S.B28). Income for state tax purposes may differ from federal gross or taxable income. *Atlantic Coast Line R. Co. v. Daughton,* 262 U.S. 413, 422-423 (1923).

The New Jersey CBT is a case in point. Although the starting point for computing net income under the CBT may be federal taxable income prior to the net operating loss deduction and special deductions, the adjustments which are made in arriving at the state tax base, including the denial of a deduction for federal taxes based on income or profits, can and do depart from federal income tax concepts (J.S. App. 13a to 14a).

The Court has made clear that state taxes are to be judged by their "practical effect" rather than formalisms or statutory words in a vacuum. *Nippert v. Richmond,* 327 U.S. 416, 433 (1946); *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977). When the issue is properly framed in terms of its practical effect, the companies' claims of extraterritorial and discriminatory taxation collapse because the portion of unitary income which the companies want to exclude from the New Jersey net income base (an amount equal to between 70% and 20% of the windfall profit, IRC § 4987(b)), is no different in character from the unitary income equal to the remainder of the windfall profit (30% to 80%) which is included in the base without objection from the companies. The geographic incidence and so-called site-specific nature of the WPT are red herrings because New Jersey is taxing its share of unitary net income, and unitary net income is not site-specific.

Even on the companies' terms, there is no geographic skewing of the New Jersey net income base, first because they cannot establish that New Jersey is including out-of-state income in the tax base while denying a deduction for associated costs, and second because the WPT is not a site-specific cost. So far as income in the ordinary course of

their businesses is concerned, the companies have no income for either federal income tax or New Jersey CBT purposes until they sell their oil or petroleum products. Treas. Reg. § 1.61-3(a). For all this record reveals, the companies' activities in New Jersey may have accounted substantially for their ultimate taxable income. *Mobil*, 445 U.S. at 438; *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 276 (1978).

In any event, the WPT is not a site-specific cost because its computation depends on many factors having nothing to do with the property where the oil is produced. The removal price, in particular, depends on such factors as the value of the oil when it reaches a refinery and transportation costs. In the case of Alaskan oil, the refinery is apt to be thousands of miles from the producing property, in New Jersey for instance, and transportation costs depend upon the applicable tariff for transporting the oil through the Trans-Alaska Pipeline System and the contractual arrangements for transporting the oil by oceangoing tanker from Valdez to the West, Gulf, or East Coasts. *GAO Report*, App. I at 5, 10, 12-14, 20, 28-32.

The denial of a deduction for the WPT neither singles out for disadvantageous tax treatment an exclusively out-of-state activity nor otherwise discriminates against interstate commerce. Any singling out was accomplished by Congress when it determined that certain crude oil producers and other holders of an economic interest with respect to taxable crude oil should pay the WPT. IRC § 4996(a)(1)(A). New Jersey cannot be faulted for applying its facially neutral, longstanding tax disallowance provision to those corporations which pay the WPT.

New Jersey's application of its tax disallowance provision to the appellants is not drawn along state lines, and thus the provision, as applied, does not violate the purpose of the Commerce Clause to create an economic free trade zone. *Armco, Inc. v. Hardesty*, 467 U.S. 638, 642 (1984). No in-state activity is being favored. The companies' in-state competition, which includes independent marketers who do not pay the WPT to the federal government and are thus not subject to the tax disallowance provision, is as much involved in interstate commerce as are the companies. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978).

Acceptance of the companies' position would create a legal nightmare. The rule would apply differently from state to state depending upon the location of crude oil. Many other so-called site-specific costs would become the subject of litigation, *e.g.* percentage depletion, intangible drilling costs, refining costs, and real property taxes. It is not apparent how a constitutional rule could be limited to situations where the site-specific nature of the cost is immutable, *e.g.* a function of a state's natural resources or lack thereof. An individual taxpayer having particularized site-specific costs outside the taxing state would be as constitutionally harmed as the victim of so-called "systemic" geographic skewing (U.S. B22). Even the definition of a site-specific cost would be problematic.

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ARGUMENT

I. APPLICATION OF THE NEW JERSEY CBT TO AN APPORTIONED SHARE OF APPELLANTS' ENTIRE NET INCOME, INCLUDING AN AMOUNT EQUAL TO THE WPT, FALLS SQUARELY WITHIN THE COURT'S PRECEDENTS

A. This Case Is Controlled By Exxon Corp. v. Wisconsin Dept. of Revenue

The Commerce and Due Process Clauses, together, impose four conditions on the imposition of a state tax. There must be a nexus between the corporation and the taxing state, the tax must be fairly apportioned to activities within the state and fairly related to in-state benefits, and the tax must not discriminate against interstate commerce. *Complete Auto Transit,* 430 U.S. at 287; *D.H. Holmes Co., Ltd. v. McNamara,* 108 S. Ct. 1619 (1988). State taxes are to be judged under this four-part test based on their "practical effect" and the "economic realities" of the situation. *Maryland v. Louisiana,* 451 U.S. 725, 756 (1981); *Complete Auto Transit,* 430 U.S. at 279; *National Bellas Hess Inc. v. Illinois,* 386 U.S. 754, 756 (1967).

Under the nexus requirement states are permitted to apply formulary apportionment to the entire unitary net income of a multistate corporation. *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 439 (1980). Unitary net income is income earned in a series of transactions that do not allow its precise source to be determined. *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920); *Mobil,* 445 U.S. at 438.

In *Exxon v. Wisconsin,* the Court held that even though there was no crude oil production in Wisconsin and Exxon could identify through its accounting procedures a separate profit for its exploration and production division, Wisconsin could nevertheless include this so-called situs income in the tax base and subject it to formulary apportionment. Since Exxon's business was unitary and the production income was part of a unitary stream of income, there was a sufficient nexus between that income and Wisconsin to satisfy both the Due Process and Commerce Clauses. 447 U.S. at 226-230. Although a producing state might tax the production income in some manner, that income was in part attributable to Exxon's activities in Wisconsin, and thus the possibility of double taxation did not impugn Wisconsin's taxing scheme. *Id.* at 229. The tax was "fairly related" to benefits provided by Wisconsin consisting of various state services. *Id.* No issue was raised that the tax discriminated against interstate commerce.

The companies admit that their integrated petroleum operations, beginning with exploration and production, moving on to refining and manufacturing, and ending with income-generating sales, are unitary businesses (App. B3) and that they have a very substantial nexus with New Jersey (J.A. 12 to 15). The companies' unitary income attributable in some measure to their oil production activities is thus as taxable here as it was by Wisconsin in *Exxon v. Wisconsin.*

Included in the companies' unitary net income for the years at issue is income attributable to the federal government's decontrol of crude oil prices. This "decontrol element" of the companies' unitary net income includes an

amount equal to the "windfall profit" which Congress isolated and defined in the WPT. Inclusion of the decontrol element and the part of it which is equal in amount to the windfall profit does not alter the character of the unitary income stream held taxable in *Exxon v. Wisconsin*. In fact, the companies do not suggest otherwise, conceding *sub silentio* that New Jersey can impose the CBT on the decontrol element of their unitary net income which is left after subtracting an amount equal to the WPT. For Tier 1 oil, for instance, they tacitly concede that New Jersey can include in their unitary income 30% of the windfall profit, which is the amount left after subtracting an amount equal to the 70% WPT on the windfall profit for Tier 1 oil. IRC § 4987(b).

The "practical effect" of denying a deduction for the WPT is to include in the companies' unitary net income the entire decontrol element, including the windfall profit. Since they have not shown that the decontrol element "was earned in the course of activities unrelated to the sale of petroleum products in" New Jersey, *Mobil*, 445 U.S. at 439, New Jersey may apply its apportionment formula to the entire amount unless the Constitution obliges New Jersey to abandon formulary apportionment in the CBT and comply with the separate accounting used by Congress in identifying a windfall profit in the WPT Act.

B. New Jersey Is Not Constitutionally Compelled to Follow the Federal Government's Treatment of the WPT

Implicit in the companies' argument is the notion that enactment of the WPT somehow preempts the normal operation of New Jersey's CBT. But there is not one word

to that effect in the WPT Act or any other federal statute or regulation, and preemption cannot be inferred from silence. *Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp.*, 56 U.S.L.W. 4307 (April 19, 1988). Absent preemption, the fact that the WPT is deductible for federal income tax purposes does not oblige New Jersey to grant a similar deduction. Congress made the WPT deductible for federal income tax purposes so that the decontrol element would not be taxed twice by the federal government—once by the WPT and a second time by the federal income tax. H.R. Rep. No. 96-304 at 45; S. Rep. No. 96-394 at 68. New Jersey does not have its own WPT, and there is thus no logical necessity for making the WPT deductible for New Jersey income tax purposes.

It is immaterial that the WPT may be a "real economic cost" (U.S. B27 to 28) or includable in cost of goods sold (App. B8). The states are not required to follow federal definitions of net income, and there is no single definition of taxable income. *Atlantic Coast Line R. Co. v. Daughton*, 262 U.S. 413, 422 n.6, 423 (1923). Even in the absence of federal taxable income, a state can tax an apportioned share of a unitary corporation's net income computed on some other basis. *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924). Income for state tax purposes may exist without realization, *see Atlantic Richfield Co. v. Alaska*, 705 P.2d 418, 421 (Alaska 1985), *appeal dism'd*, 474 U.S. 1043 (1986), may include as income items not thought to constitute income for federal income tax purposes, *Commissioner of Revenue v. Massachusetts Mutual Life Ins. Co.*, 384 Mass. 607, 428 N.E. 2d 297, 305 (Mass. 1981), and deductions may be denied that under the fed-

eral income tax might be deemed "real economic costs." *Atlantic Coast Line R. Co.; Mobil Oil Corp. v. Ley*, 142 Wis. 2d 108, 416 N.W.2d 680 (Ct. Ap. 1987), *pet. for rev. denied* (May 3, 1988).

In the New Jersey CBT, the adjustments to entire net income depart from the concept of federal taxable income. N.J.S.A. 54:10A-4(k) (J.S. App. 13a to 14a). In addition to the disallowance for "taxes paid to the United States on or measured by profits or income," a portion of interest on debt to 10% or more shareholders, net operating losses, and the federal income tax were not allowed as deductions under the CBT in the years at issue.[11] These are as much "real economic costs" as is the WPT.

In the WPT Congress may have isolated a discrete portion of the companies' unitary income, namely the windfall profit, but Congress' application of a separate accounting concept in a federal tax does not force New Jersey to do likewise. New Jersey need not abandon the unitary business principle and formulary apportionment and in its place adopt the federal government's assumption in the WPT Act of a definable, separable wellhead profit. *Container Corp.*, 463 U.S. at 184-197. As the companies themselves recognize (App. B19), quoting from *Mobil*, 445 U.S. at 438:

> Separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

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[11] N.J.S.A. 54:10A-4(k)(2)(D), (E) and (C) (App. to Motion to Aff. in No. 87-453 at 2a). Until 1985, N.J.S.A. 54:10A-4(k)(2)(D) disallowed the federal net operating loss deduction permitted under IRC § 172. 1985 N.J.L. c. 143.

C. Denial of a Deduction for the WPT Meets the Four-Part Test of Complete Auto Transit, Inc. v. Brady

New Jersey is taxing net income, not deductions, and it is thus the nature of the taxed income that is determinative, not the nature of the disallowed cost. The only constraints on the states' denial of so-called site-specific out-of-state costs are those set forth in *Complete Auto Transit*, to which we now turn.

Denying a deduction for a so-called out-of-state cost does not eliminate the nexus between appellants' so-called oil production income and New Jersey. The companies have a very substantial presence in New Jersey (J.A.12 to 15), and the measure of the tax remains New Jersey's share of their unitary net income. Thus, as the Solicitor General correctly points out (U.S. B17 and n.17), the practical economic effect of denying a deduction for the WPT is not the equivalent of New Jersey's imposing its own WPT or a severance tax on oil producing activities outside New Jersey. If this were not the case, no state could deny a deduction for a so-called situs-based tax arising outside its borders, *e.g.*, real estate taxes, severance taxes, or stock transfer taxes (even if the state denied a deduction for a similar in-state tax) because denying the deduction would effectively impose that kind of situs-based tax on out-of-state activities.

For analogous reasons, denial of a deduction for the WPT does not convert the CBT to a tax which is not "fairly related" to the cost of benefits provided by the

state. Since the companies do a substantial business in New Jersey and since the measure of the tax remains a share of their unitary net income, the measure continues to be related to governmental costs incurred to provide a civilized society. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 628-629 (1981), *and see* U.S. B17.

Denial of a deduction for the WPT does not transform New Jersey's fairly apportioned tax to one that is unfair. The companies do not question the propriety of New Jersey's three-factor formula (App. B14). Nor do they question New Jersey's right to apply that formula to the decontrol element of their entire net income apart from an amount equivalent to the WPT. See above at 16. How New Jersey's apportionment of the companies' net income becomes unfair when New Jersey subjects to formulary apportionment the remaining portion of the decontrol element is unclear.

What is clear is that denial of the deduction does not violate any of the Court's precedents dealing with fair apportionment. First, denial of the deduction meets the Court's internal consistency test. *Container Corp.*, 463 U.S. at 169. If every state denied a deduction for the WPT, the result would be that the entire portion of the decontrol element equivalent in amount to the WPT, but no more than 100% of that amount, would be subject to tax. While a producing state might separately account for oil production income and tax the full amount of that income within its borders, this does not preclude New Jersey from taking that income into account in determining the companies' apportionable New Jersey income. *Moorman Mfg.*, 437 U.S. at 273. What New Jersey is taxing is its

share of the companies' worldwide production, refining, and marketing income. A producing state which uses separate accounting is also measuring income within its borders but doing so by a different method. Double taxation, should it exist, "is not the inevitable result of the [New Jersey] taxing scheme." *Container Corp.*, 463 U.S. at 188; *Exxon v. Wisconsin*, 447 U.S. at 228-230.

Denial of the deduction meets as well the Court's external consistency test, *Container Corp.*, 463 U.S. at 169, because there is no proof that application of the three-factor formula to the companies' unitary net income, including an amount equal to the entire decontrol element and windfall profit, does not "actually reflect a reasonable sense of how income is generated." *Id.* Since the companies concede that New Jersey can subject a portion of the decontrol element of their unitary income to formulary apportionment, there cannot be an inherent or inevitable asymmetry (*cf.* App. B22 to 25) in apportioning the income equal in amount to the remainder of the decontrol element. The difference is merely the amount of income subjected to apportionment.

There is no proof in this record that subjecting the companies' unitary income, including an amount equal to the WPT, to New Jersey's apportioned tax attributes too much of their net income to the state. Ten of them argued below that virtually all of their income is derived from "post-'removal' sales to third parties of . . . barrels [of crude oil] or finished products refined therefrom" (Brief of Atlantic Richfield Company *et al.*, Superior Court of New Jersey, Appellate Division, Docket Nos. A-2795-84T7 and following, at 68. *See also* J.A. 18

to 19). The companies realize no income until their crude oil has been sold (generally away from the wellhead) or refined, manufactured, and sold. Treas. Reg. § 1.61-3(a). What New Jersey is taxing is an apportioned share of that realized income. N.J.S.A. 54:10A-4(k); N.J.S.A. 54:10A-5(c) (J.S. App. 94a to 95a). The companies concededly have extensive operating facilities in New Jersey (J.A. 12 to 15). There is no proof in this record that New Jersey's share of the companies' unitary net income, including the full decontrol element, was not earned as much through the companies' refining, manufacturing, petrochemical operations, and selling activities in New Jersey as through their oil production activities in other states.

The amount of CBT owed by the companies when a deduction for the WPT is denied is not excessive. *Cf.* App. B23. As made clear in the table included in Appendix C to this brief, in all but two cases for the two years at issue, imposition of a 1% gross receipts tax on each of the companies' New Jersey receipts would have yielded a greater tax than did imposition of the CBT on their apportioned entire net income without a deduction for the WPT. *See Moorman Mfg.*, 437 U.S. at 280-281.

Denial of a deduction for the WPT does not make the CBT discriminatory in application. If New Jersey can constitutionally tax the companies' unitary income including a portion of the decontrol element, the CBT does not become discriminatory when New Jersey taxes their unitary income equal in amount to the remainder of the decontrol element. State lines are as irrelevant here as they were in *Exxon v. Wisconsin*, and "the Commerce Clause is not offended when state boundaries are economically

irrelevant." *American Trucking Ass'ns v. Scheiner*, 107 S.Ct. 2829, 2840 (1987). The "practical economic effect" of denying a deduction for the WPT is simply to include in the unitary tax base an amount equal to the entire decontrol element. This does not threaten the economic free trade area protected by the Commerce Clause. *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328 (1977).[12]

II. APPELLANTS' ASSERTION THAT THE WPT CREATES A CONSTITUTIONAL BARRIER TO THE NORMAL OPERATION OF NEW JERSEY'S CBT HAS NO BASIS IN LAW

The companies repeatedly assert that denial of a deduction for the WPT impermissibly skews the unitary net income base, singles out for disadvantageous tax treatment an exclusively out-of-state activity, and discriminates against interstate commerce. Indeed, if repetition of the charged words "tailored" and "skewed," without more, could win the day, there would be no hope for the CBT.

A. There Is No Impermissible Skewing of the Tax Base

Denial of a deduction for the WPT does not skew the net income base of the CBT regardless of whether the WPT is a site-specific cost. If New Jersey can tax an apportioned share of the companies' unitary net income

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[12] The Equal Protection Clause, which provides alternative, but no greater, constitutional protection for out-of-state corporations, *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648 (1981), does not present a separate issue here. *See* App. B41, 48; U.S. B10.

including income attributable in some degree to their crude oil production activities in other states, which it clearly can under *Exxon v. Wisconsin*, and if New Jersey can tax the segment of the decontrol element of their unitary income which is left after subtracting an amount equal to the WPT, which the companies tacitly concede is permissible, the net income base does not suddenly become skewed when New Jersey taxes the portion of unitary income equal in amount to the WPT. Whether the WPT is site-specific is irrelevant.

Even under the companies' and the Solicitor General's formulation of the issue, there is no skewing of the tax base because, first, the companies do not and cannot establish that the tax base includes a disproportionate amount of out-of-state income, and, second, the WPT is not a site-specific cost. New Jersey is neither taxing "out-of-state income unencumbered by out-of-state costs" (App. B30), nor is it "asymmetrically including receipts without allowing deductions for associated costs" (U.S. B16).

1. Appellants Have Not Shown That New Jersey Is Taxing Out-Of-State Income

As pointed out above at 21-22, no income is realized for income tax purposes absent a sale or other event which triggers realization, and the bulk of the companies' gross receipts derive from the sale of petroleum products, not from sales of crude oil at the wellhead. Nothing in this record establishes the amount of the companies' gross receipts from sales of crude oil at the wellhead (*cf.* J.A. 18 to 19), and even if such an amount could be established, the figure would include receipts from sales of crude oil

produced by the companies on which they paid the WPT and sales of crude oil *purchased* from other producers on which the companies, as purchasers of the oil, did not bear the burden of the WPT (*id.*).[13] Since the companies' net income arises from a series of transactions beginning with exploration and production, with no income for tax purposes absent a sale, *Bass, Ratcliff*, 266 U.S. at 282 (1924), they have no way of establishing that their net income is attributable in any specific amount to any particular geographic location. *Mobil*, 445 U.S. at 438. In light of the companies' extensive operations in New Jersey, it is just as plausible to assume that the bulk of their unitary net income was attributable to refining, manufacturing, and marketing activities within the state as it is to assume that their unitary net income was attributable to oil production outside New Jersey. *Moorman Mfg.*, 437 U.S. at 272.

The companies would have this Court remove from the CBT base a segment of their unitary net income equal to the WPT. Since this segment of their income is economically real, it is misleading to equate its inclusion with the doubling of income from an out-of-state activity (*cf.* App. B28), doubling the numerator of the companies' payroll fraction (*cf.* App. B24), or excluding oil production property from the denominator of their property fraction (*cf.* App. B25). Any of these adjustments would artificially augment their business income by factors bearing no relation to economic reality.

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13 The WPT is paid by the producer, but the first purchaser must withhold and remit the tax, much as in the case of federal income tax withholding. IRC § 4986(b); IRC § 4995(a)(1).

2. In Any Event, The WPT Is Not Site-Specific

The entire factual predicate for the companies' and the Solicitor General's position is that the WPT is a purely site-specific and exclusively out-of-state cost (App. B14 to 18; U.S. B23 to 25), and both concede that their theory applies "*only* to costs that are properly identified as site specific" (App. B31; U.S. B21, emphasis supplied). In fact, the WPT is not site specific.[14] At least three factors necessary to its computation—the removal price, inflation adjustment, and net income limitation—are not site-specific.

The removal price is either the sales price, or, if there is no sale (as in the case of a downstream transfer to an integrated oil company's refinery), the removal price is "the representative market or field price of the oil or gas before conversion or transportation." IRC § 4988(c); Treas. Reg. § 1.613-3(a). The representative market or field price depends upon what price the crude oil will bring in the marketplace, which may or may not be in the vicinity of the producing property, and if the market is not in the vicinity, the market price must be reduced by transportation costs. Rev. Rul. 83-161, 1983-2 C.B. 202. Although unique in many ways, Alaskan North Slope oil is a case in point. As Exxon's vice president of supply testified in hearings on the windfall profit tax and Alaska North Slope oil producers ("*ANS Hearing*"):[15]

> For crude run in our own refineries, the value [of Alaska North Slope crude oil for WPT purposes] is determined on a continuing basis from our best assessment of the term [sic] market value of the crude *in the area where it is refined*, for example, west coast or gulf [/] east coast.
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> . . . . .
>
> We believe our approach for establishing the removal price is appropriate because the key determinants in valuing North Slope crude, *or any other crude, for that matter*, are the price it will bring in the marketplace and the transportation cost to get it there. [*ANS Hearing* at 11, emphasis supplied].

Seven of the companies have interests in Alaskan North Slope oil, and of these Atlantic Richfield and Exxon have sizable interests. *GAO Report*, App. I at 6.[16] In 1982, 8% of Alaska North Slope ("ANS") oil was delivered through the Trans-Alaskan Pipeline System and by ocean-going tankers to the East Coast, some of this to New Jersey,[17] while 47% was delivered to the West Coast and 32% to the Gulf Coast. *Id.* at 6, 8. Since there are no

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[14] While New Jersey has stated, correctly, that the WPT has "a geographic source outside the State," it has never conceded that the so-called oil production income on which the WPT is imposed is an exclusively out-of-state segment of appellants' unitary business income and has consistently maintained that the WPT is unlike a site-specific severance tax (Motion to Affirm at 14; Brief in Response to U.S. at 10 n.9).

[15] *The Windfall Profits Tax and Product Marketing Consequences of the Wellhead Pricing Practices of Alaska North Slope Crude Oil Producers: Hearings Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce* (February 23, 1983).

[16] *See* fn. 5 above.

[17] In 1982 Exxon's share of ANS oil averaged 325,000 barrels per day, of which approximately two thirds or 216,645 barrels were delivered to the Gulf and East Coasts. Of this amount, 30% or 64,994 barrels per day were delivered to Exxon's only refinery on the East Coast in Linden, New Jersey. *ANS Hearing* at 10; *National Petroleum News, Fact Book Issue*, Mid-June 1981 at 204.

sizable markets near the North Slope, a "wellhead price, per se, does not exist for North Slope oil." *Id.* at 10. Producers thus construct a removal price for purposes of the WPT by valuing the oil at the refinery gate in a market area in the lower 48 states and deducting transportation costs from this amount. Rev. Rul. 83-161, 1983-2 C.B. 202. During the period covered by the *GAO Report*, Exxon determined the wellhead value of its ANS crude based on an assessment of its market value in the area where the crude was refined, *GAO Report*, App. I at 13, including Exxon's Bayway Refinery in Linden, New Jersey. Atlantic Richfield valued all its ANS crude based on the market price for West Texas Sour in the Gulf Coast even when the oil was delivered to the company's West Coast refinery. *Id.* at 13, 10; *ANS Hearing* at 5.[18] Some of the smaller producers used foreign crude oil as a benchmark to determine the value of their ANS oil. *GAO Report*, App. I at 14.

Further differences in the removal price of ANS oil result from differing transportation costs. Some of the producers use their own tankers to transport the oil, *e.g.* Atlantic Richfield, while others use chartered tankers, *e.g.* Exxon, *id.* at 13, 29, and the eight owners of the Trans-Alaska Pipeline System charge different tariffs to transport the oil from the North Slope to Valdez. *Id.* at 20. Further differences relate to the deduction of field

[18] The difficulty of valuing ANS oil is underlined by the recent assessment of $1 billion in WPT deficiencies and interest for the period 1980-1983 against Atlantic Richfield on account of the company's valuation of its ANS oil. *See Wall Street Journal*, July 19, 1988 at 6; *New York Times*, July 19, 1988 at D1.

costs and pipeline losses and to the time at which a removal price is established. *Id.* at 14-15. Some producers determine a price for WPT purposes at the wellhead when the oil is removed, while others value the oil upon delivery to a refinery, *e.g.* in New Jersey, which may be two or three months after removal. *Id.*

ANS oil is not the only oil to be valued based on factors far distant from the wellhead. As Exxon's vice president of supply testified (see above at 27), the same kinds of factors apply in establishing the value (or removal price) of any crude oil. In fact, the basic measure of wellhead value is the "posted price," which is the price that refiners, often located at a substantial distance from the field, are willing to pay for the oil based on their own demand and supply factors at the time. *See e.g.* Revision of Oil Product Valuation Regulations, 53 Fed. Reg. 1184, 1220 (January 15, 1988) (Dept. of Interior, Minerals Management Service).

The inflation adjustment is a significant component in computing the windfall profit. The adjustment increases the base price to arrive at the adjusted base price, and the adjusted base price (plus severance tax adjustment) is deducted from the removal price to determine the taxable windfall profit. IRC § 4989(a); IRC § 4988(a). The inflation adjustment, defined in IRC § 4989(b), increases the base price by the amount of inflation in the gross national product since June 30, 1979. An additional adjustment is permitted for Tier 3 oil. IRC § 4989(b)(2). During the period at issue the inflation adjustment for Tiers 1 and 2 ranged from 1.95% in the first quarter of 1980 to 18.61% for the fourth quarter in 1981 (J.A. 30).

Price inflation in the general economy is plainly not tied to a single oil producing property.

The net income limitation ("NIL"), which substantially reduced the companies' WPT liabilities during the years at issue (JA. 21), is not a site-specific computation and is a computation made, not at the time of removal, but rather on an annual basis. IRC § 4988(b)(2). It is thus fundamentally incorrect to state that the WPT is measured at the time of removal (*cf.* App. B35). The WPT is not fully measured until the end of the taxable year. For crude oil not sold at the wellhead the starting point for computing the NIL is affected by the same off-site factors, that affect the removal price, *i.e.* the value of the oil in the market where it is refined and transportation costs. IRC § 4988(b)(3); Treas. Reg. § 51.4988-2(b)(i). Once gross income from the property is determined, a producer deducts all expenses directly attributable or allocable to the production process with the exception of percentage depletion, the WPT itself, intangible drilling costs, and certain "qualified tertiary injectant expenses." IRC § 4988(b)(3); Treas. Reg. § 51.4988-2(b)(ii).[19] Deductible expenses include operating expenses, certain selling expenses, administrative and financial overhead, depreciation, taxes deductible under IRC § 162 or 164, losses sustained, and exploration and development expenditures. Treas. Reg. § 1.613-5(a). At the very least, administrative and financial overhead and income taxes deductible under Section 162 or 164 are not site-specific costs.[20] The form on which the companies compute the NIL (J.A. 32 to 33) confirms that expenses incurred away from the producing property such as "overhead" (Line 7) and "expenses not solely attributable to the production of taxable crude oil" (Line 10) are deductible in determining the taxable income from the property.

It is thus inaccurate to state, as does the Solicitor General, that "the measure of the windfall profit tax is a figure tied to the particular producing property (in a particular state) at the time of removal" (U.S. B25). It is equally inaccurate to state, as do the companies, that the WPT is "effectively measured by the value of crude oil at the time and place of removal" (App. B17). The measurement depends upon market factors including, in the case of Exxon's East Coast deliveries of ANS Oil, the value of that oil to Exxon at its refinery in New Jersey, inflation in the general economy, and an annual net income computation which takes into account so-called "hot-

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[19] Although disallowed as current deductions, these expenditures, with the exception of the WPT, are recovered over time through cost depletion in the NIL computation. IRC § 4988(b)(3)(C).

[20] *Shell Oil Co. v. Commissioner*, 89 T.C. 371 (1987), involved several issues in computing the NIL. The United States Tax Court upheld Shell's position that interest expense incurred in connection with Shell's acquistion of the Belridge Oil Company was a general corporate overhead expense which could be allocated among Shell's producing and nonproducing properties thereby reducing Shell's net income for purposes of the NIL. The parties agreed that state income and franchise taxes were part of general corporate overhead to be allocated among Shell's various activities based upon relative net income. The parties disagreed as to whether the WPT should be included in a base under which indirect expenses would be allocated to Shell's producing properties. The court held that the WPT could be included in the base because enactment of the WPT caused the taxpayer to incur additional administrative costs.

tom line'' taxes (U.S. B25) and general corporate overhead.

The companies and the Solicitor General are in a distinct minority in their view that the WPT is a site-specific cost akin to a severance tax. The WPT does not meet Congress' definition of a severance tax in the WPT Act itself because it is not measured by the "gross value of the extracted oil.'' IRC § 4996(c)(2); Treas. Reg. § 51. 4996-2(b). Nor is the WPT imposed on the act of removal but rather on the windfall profit. IRC § 4986. The Internal Revenue Service states in its manual: "Although the WPT is by Congressional definition an excise tax, its structure and computation bear more resemblance to an income tax.'' *I.R.S. Manual Supplement—Windfall Profit Tax Program*, 42 RDD-57 (Rev. 3) August 28, 1987 § 2.01. This Court, in its brief characterization of the WPT, has called it a tax on "additional revenues,'' *Ptasynski*, 462 U.S. at 76, and state and lower federal courts have agreed. *Exxon Corp. v. City of Long Beach*, 812 F.2d 1256, 1259 (9th Cir. 1987); *Tenneco West, Inc. v. Marathon Oil Co.*, 756 F.2d 769, 773 (9th Cir. 1985) *cert. den.* 474 U.S. 845 1985); *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal. App. 3d 6, 10, 189 Cal. Rptr. 302, 304 (Ct. App. 1983); *Lewis v. Reagan*, 516 F. Supp. 548, 553 (D.D.C. 1981).[21]

[21] The shorthand characterization of the WPT as a severance tax in the committee reports (H.R. Rep. No. 96-304 at 2; S. Rep. No. 96-394 at 2) cannot override Congress' definition of a severance tax in the Act itself in such manner as to exclude the WPT, nor does that characterization accurately describe the actual operation of the WPT, which resembles to some extent

(Continued on following page)

This is not to say that the WPT operates exactly like the federal income tax. The WPT is a unique tax (*GAO Report*, App I at 1), having characteristics of both an income tax and a transactional excise tax. As the WPT is truly unique, it does not advance the inquiry to suggest as does the Solicitor General (U.S. B24 to 26), that, as New Jersey has no comparable tax for which it denies a deduction, New Jersey should not be able to deny a deduction for the WPT. If, as the Internal Revenue Service maintains, the WPT more closely resembles an income tax, under the Solicitor General's theory, those states that deny a deduction for the federal income tax, including New Jersey, may deny a deduction for the WPT. *See* Appendix B to this brief.[22]

(Continued from previous page)

an income tax. The characterization of the tax in IRC § 4986(a) as an excise tax does not imply that it is site-specific. The excise tax on the undistributed income of regulated investment companies, which precedes the WPT in the Internal Revenue Code, is not, under appellants' apparent understanding of the concept, site-specific. IRC § 4982. The CBT itself is an excise or franchise tax. J.S. App. 29a to 30a; *Cities Service Co. v. Taxation Div. Director*, 5 N.J. Tax 257, 271 (N.J. Tax Ct. 1983).

[22] The companies' suggestion that the WPT resembles a severance tax because a producer remains liable for the tax even if the oil is lost subsequent to removal (App. B35) and the Solicitor General's suggestion that the WPT operates like a severance tax in that it functions as a cost of earning income not as a payment out of income earned (U.S. B28) are not borne out by the facts of this case. The companies lose virtually no barrels of oil subsequent to removal (J.A. 19), and some of them treated the WPT as a tax expense paid out of income earned rather than as a cost of earning income. *See* Appendix A to this Brief at 3a, 1a. In any event, the failure to allow a credit or refund on account of downstream losses and imposition of the tax in the process of earning income would not negate the fact that the measurement of the WPT is not geographically localized, which is the entire foundation for the companies' and the Solicitor General's position.

B. The CBT Is Not Tailored To Disadvantage Out-of-State Oil Producers and Does Not Otherwise Discriminate Against Interstate Commerce

1. Congress, Not New Jersey, Singled Out Oil Producers For Special Tax Treatment

Whatever tailoring or singling out there may be in this case was accomplished, not by New Jersey, but by Congress in determining that oil producers should pay a special tax. *See* U.S. B13. In those instances where Congress determined that certain oil should not be burdened by the WPT, *e.g.* certain Alaskan oil,[22A] New Jersey's tax disallowance provision does not come into play. Conversely, where Congress determined to impose the WPT at a lower rate, e.g. on newly discovered oil, New Jersey's tax disallowance provision operates with a reduced effect, and where Congress chose to impose the WPT at the highest rate, *i.e.* 70% on Tier I oil produced by integrated companies, New Jersey's tax disallowance provision operates accordingly. IRC § 4987(b). The CBT does not even single out integrated oil producers. *Cf.* App. B24. The tax disallowance provision applies to any corporation which pays the WPT, including chemical companies and conglomerates (J.A. 34), and any other "holder of the economic interest with respect to [taxable] crude oil." IRC § 4986(b); IRC § 4996(a)(1). As the Internal Revenue Service states in its manual, "[The WPT] will affect almost every taxpayer who owns any kind of interest in an oil well." *I.R.S. Manual Supplement, supra,* § 2.02. A

[22A] IRC § 4991(b)(3); IRC § 4994(e); *see also Ptasynski*, 462 U.S. at 78.

New Jersey pharmaceutical company or real estate development company having a limited partnership investment in a drilling partnership would be subject to the WPT and the CBT's tax disallowance provision. Treas. Reg. § 51.4996-1(b)(2).

The companies are simply wrong in asserting that New Jersey is "singling out for special tax burdens a form of business activity conducted only in other jurisdictions" (App. B44). Out-of-state oil production is neither the subject nor the measure of the CBT. New Jersey is imposing the CBT on the companies' exercise of the privilege of doing business in New Jersey measured by their apportioned New Jersey income. N.J.S.A. 54:10A-2; N.J.S.A. 54:10A-5(c) (J.S. App. 93a to 95a).

There is no indication that New Jersey has lowered the CBT rate on in-state activities nor increased the rate on out-of-state activities. The Commerce Clause is not violated merely because a state tax increases the cost of doing an interstate business. *Western Livestock v. Bureau of Revenue,* 303 U.S. 250, 254-255 (1938); *Washington Rev. Dept. v. Stevedoring Ass'n,* 435 U.S. 734, 748 (1978).[23]

[23] The American Mining Congress and the Natural Gas Supply Association argue that formulary apportionment assumes roughly equal rates of return in every jurisdiction and that denying a deduction for the WPT violates this assumption because the result is too much oil production income in relation to other income. But for the reasons stated at 24 to 25 above, there is no evidence that New Jersey is taxing too much income attributable to oil production. Unless appellants can show that the entire apportionment formula (*i.e.* the net income base including the full decontrol element, multiplied by the three-factor apportionment formula) results in significant

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Any number of state tax provisions may have a disparate effect on intrastate and interstate commerce and yet not be discriminatory. For instance, New Jersey denies a deduction for the federal income tax under the provision at issue here. The provision does not become discriminatory because some industries doing primarily an interstate business have a higher effective federal income tax rate (and thus a bigger federal income tax disallowance in New Jersey) than have some other industries doing primarily an in-state business. Likewise, an interstate industry with heavy capital investment and eligible to claim the accelerated cost recovery system ("ACRS") deduction under IRC § 168[24] is not discriminated against by

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distortion, it does them no good to attack only a single element in the equation. *Norfolk & W.R. Co. v. North Carolina,* 297 U.S. 682, 688 (1936). Moreover, the premise of the argument is wrong. In the short run, rates of return most likely do vary from jurisdiction to jurisdiction, one factor being the "difficulty [and in the case of crude oil production, the impossibility] of shifting resources," *Container Corp.,* 463 U.S. at 183, n.20, and another factor being severe market shocks such as the actions of the OPEC cartel and the lifting of domestic oil price controls. As made clear in *Container,* formulary apportionment is nevertheless acceptable absent proof that separate accounting is more accurate. *Id.* at 183-184. Here, as distinct from the situation in *Container,* there is no evidence at all that separate accounting for the amount of the WPT would produce a more accurate computation of appellants' unitary income.

[24] ACRS is effective for tangible property placed in service after 1980 and before 1987. Pub.L.No.97-34, § 201(a); 95 Stat. 204-205; Pub.L.No.99-514, § 203(a)(1)(4), 100 Stat. 2143; IRC § 168. ACRS, in general, liberalized the rules for recovering the cost of depreciable property. IRC 168(b) (prior to amendment by Pub.L.No.99-514). ACRS was modified in 1984 and curtailed by the Tax Reform Act of 1986 for property placed in service after December 31, 1986. IRC § 168 (as amended by Pub.L.No. 99-514).

the disallowance in the CBT of the excess of the ACRS deduction over pre-1981 federal income tax depreciation. N.J.S.A. 54:10A-4(k)(2)(F) (Motion to Affirm, App. 3a).

2. Exxon v. Maryland Disposes of Appellants' Discrimination Claim

Even if New Jersey had singled out integrated oil companies for special tax treatment, the tax disallowance provision would be constitutional under *Exxon v. Maryland,* 437 U.S. 117 (1978). There, the Court upheld a Maryland statute that prohibited integrated producers and refiners from retailing gasoline within the state against the claim that the statute discriminated against interstate commerce. *Id.* at 124-125. As Maryland had no crude oil production or refineries, there could be no disparate treatment of similar in-state activities, and since the independent marketers with whom the integrated producer refiners competed were not wholly intrastate, the distinction drawn by the statute was not based on state lines but on the nature of the companies' businesses. *Id.* at 125-126; *Lewis v. BT Investment Managers, Inc.,* 447 U.S. 27, 42 (1980). Nor did the regulation affect the flow of goods in interstate commerce, because, again, the independent retailers were as much a part of that commerce as the integrated producer refiners. *Exxon v. Maryland,* 437 U.S. at 126, n.16. Similarly here, to the extent that integrated oil companies can be thought to bear a cost that independent marketers do not, that distinction is not based on state lines, but rather on the nature of the companies'

businesses and the fact that Congress decreed they should pay the WPT.[25]

3. The New Jersey State Line Is Irrelevant Here

Denying a deduction for the WPT neither favors the local New Jersey economy nor sets New Jersey apart from the other states. There is no in-state oil production, and

[25] Appellants, the Solicitor General, and *amici* Committee on State Taxation of the Council of State Chambers of Commerce *et al.* ("COST") suggest that *Exxon v. Maryland* is distinguishable because it involved a state regulatory, rather than a tax, measure, and COST more pointedly states that state regulatory measures are entitled to more deference under the Commerce Clause than state taxes (App. B48; U.S. B22 n.22; COST B15 and n.16). The only authority cited for this proposition is *Freeman v. Hewitt*, 329 U.S. 249 (1946), where a majority of the Court held that a direct tax on commerce would be struck down for that reason alone and buttressed its holding by stating that, as a state could obtain its revenues from other sources than a direct tax, a state tax was owed less deference than a police regulation incidentally affecting commerce. 329 U.S. at 253. The distinction between direct and indirect taxes on interstate commerce disappeared with *Complete Auto Transit*, and the notion that a state tax is subject to stricter scrutiny because "revenue serves as well no matter what its source" should follow the same path. The fact that a state *could* have chosen another levy as a revenue source says nothing about the practical effect of the levy it *did* choose. Moreover, the absence of a balancing test in *Complete Auto Transit* and the Court's other tax cases under the Commerce Clause indicates that a state's "significant interest" in raising revenue to support its sovereign government, *Washington v. Stevedoring Ass'n*, 435 U.S. at 748, is sufficiently strong that in the absence of a protectionist motive or effect, that interest generally outweighs any incidental effect on interstate commerce. In this respect it might be said that state taxes that are not clearly protectionist are entitled to *greater* deference under the Commerce Clause than state regulatory measures, which are subjected to a balancing test. *See Pike v. Bruce Church*, 397 U.S. 137, 142 (1970); *Hughes v. Oklahoma*, 441 U.S. 322, 331, 336-338 (1979).

if there were the tax disallowance provision would apply equally to it. The tax disallowance provision thus does not have the tendency to force comparable out-of-state activities to be performed in-state. *Cf. Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406 (1984); *American Trucking Associations*, 107 S.Ct. at 2842. As no comparable in-state activity is being favored, more than a "slight twist" distinguishes this case from *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977) and *Westinghouse Electric* (*cf.* App. B43 to 44). It is a contradiction in terms to maintain that a state tax discriminates against interstate commerce if it does not advantage some in-state element or single out the taxing state for advantageous treatment. As the Court pointed out in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984):

> Virtually every discriminatory statute allocates benefits or burdens unequally; each can be viewed as conferring a benefit on one party and a detriment on the other, in either an absolute or relative sense. [*Id.* at 273].

Where, as here, no in-state element is being favored, an essential element in the discrimination equation is missing. While independent marketers may be treated differently under the CBT because they do not pay the WPT,[26] that

[26] Appellants' example purportedly showing that producer/marketers have a higher net income than non-producer/marketers solely on account of New Jersey's denial of a deduction for the WPT (App. B46) suffers from the same misconception as the rest of their argument. As the WPT is a function of a producer/marketer's so-called wellhead profit, which in turn is part of the producer/marketer's unitary net income, the example merely establishes that a company with higher profits has a larger New Jersey tax base. Indeed, the price paid by the non-producer/marketer reflects the WPT, if any, paid by the producer.

distinction does not relate to state lines. *See* U.S. B13. As no in-state element is favored, cases like *Westinghouse Electric*, *American Trucking*, and *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963), have no bearing here.

Amici Committee on State Taxation of the Council of State Chambers of Commerce and others ("COST") point to *Philadelphia v. New Jersey*, 437 U.S. 617 (1978), for the proposition that a state statute can discriminate against interstate commerce even though it favors no in-state interest (COST B19). While the New Jersey statute in that case did not necessarily favor local economic interests, it manifestly drew a distinction based on the New Jersey state line. Out-of-state garbage could not be dumped in New Jersey landfills, while in-state garbage could be. Here, the New Jersey state line is irrelevant. New Jersey has not set up a wall around itself and is not isolating itself from the national economy.

Denying a deduction for the WPT will not lead to "economic Balkanization" (*cf.* COST B6 to 7, 11 to 14). Since New Jersey is taxing the in-state attributes of the companies' unitary businesses and is drawing no distinctions based on state lines, other states have no cause to complain. COST's claims that we are witnessing the opening salvos of a trade war between the producing and nonproducing states (COST B13) are belied by the facts that Kansas, which in 1986 produced 67,034,000 barrels of crude oil, has recently denied a deduction for the WPT (*see* App. B33 n.14) and that California and Wyoming,

both of which have substantial oil production,[27] have joined in an *amicus* brief, along with other producing and nonproducing states, on New Jersey's behalf.

III. APPELLANTS' PROPOSED CONSTITUTIONAL RULE WOULD BE UNWORKABLE

The Court once observed that its Commerce Clause decisions in the state tax area "have been 'not always clear . . . consistent or reconcilable . . .' " and has characterized those decisions as a "quagmire." *Portland Cement Co. v. Minnesota,* 358 U.S. 450, 458 (1959). In *Complete Auto Transit* the Court clarified the area by establishing a straightforward four-part test. The companies' proposed constitutional rule, which would prohibit the states from denying a deduction for a so-called site-specific cost when the cost is incurred exclusively, or almost exclusively, out-of-state would destroy the clarity achieved in *Complete Auto Transit.*

A. The Rule Would Apply Differently From State To State Depending Upon The Location Of The Activity for Which a Deduction is Being Denied

New Jersey presently has no oil production nor proved reserves. It is not out of the question that the situation might change.[28] Under the companies' theory, Kansas,

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[27] U.S. Dept. of Energy, Energy Information Administration, Office of Oil and Gas, *Petroleum Supply Annual,* Table 9 (May, 1987) (hereafter "1987 *Petroleum Supply Annual*").

[28] On October 4, 1983, the *New York Times* reported at page B1, that brokers for a Texas drilling company had been

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which denies a deduction for the WPT (App. B33 n.14) and has a substantial amount of oil production, would not be subject to attack. New York, which is an *amicus* in this case, had oil production in 1986 amounting to 853,000 barrels. Appellants imply that New York's provision denying a deduction for the WPT, which is virtually identical to New Jersey's, is unconstitutional (App. B16), but what about Pennsylvania with 3,783,000 barrels of production in 1986, or Michigan, another *amicus* in this case, with 1986 production of 25,688,000 barrels?[29] Where is the line to be drawn?

Several states have no oil refineries.[30] If the Court adopted the companies' argument in this case, presumably they would insist that these states could not deny deductions for any refinery costs.

Depletion is another so-called site-specific cost. As pointed out in New Jersey's brief in response to the United States at 7 to 8, for federal income tax purposes, there are two kinds of depletion—cost and percentage. As it is based on income from a producing property rather than

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seeking to lease mineral rights in Somerset and Hunterdon Counties near the town of Readington, New Jersey. Readington lies over a geologic formation called the Newark Basin, thought to contain reserves of crude oil. The company subsequently withdrew from New Jersey after drilling an exploratory well across the Delaware River in Pennsylvania which came up dry. *Newark Star Ledger*, October 25, 1985, at 29.

[29] 1987 *Petroleum Supply Annual.*

[30] As of January 1, 1980, there were no oil refineries in Connecticut, Idaho, Iowa, Maine, Massachusetts, Rhode Island, South Carolina, South Dakota, or Vermont. *National Petroleum News, Fact Book Issue, supra* at 203-205.

capital costs, percentage depletion is often more advantageous than cost depletion. In 1975, Congress eliminated the deduction for percentage depletion for most oil and gas producers, including those like appellants which refine or retail oil. IRC § 613A(d)(2); IRC § 613A(d)(4). Percentage depletion continues to apply at the federal level for numerous other minerals. IRC § 613(b). Many states have their own depletion rules. *See* Appendix B to this brief and *see generally*, 1 Multistate Corp. Income Tax Guide (CCH) ¶ 89. To the extent that minerals eligible for percentage depletion under federal law are not found in a state that limits all depletion to cost, acceptance of the companies' position would raise the question whether denial of a deduction for percentage depletion unconstitutionally skews the net income base.

B. As Applied To The WPT The Rule Would Be Irrational

Congress enacted the WPT in the belief that the additional profits realized by oil producers as a result of the decontrol of oil prices and actions of the OPEC cartel should be further taxed. To do so it enacted a separate tax and made that tax deductible for federal income tax purposes. IRC § 164(a)(5). Certain crude oil is taxed at a lower rate, *e.g.* newly discovered oil, and some is exempted entirely, *e.g.* certain Alaskan oil. IRC § 4987; IRC § 4991 (b). Under the companies' proposed rule, the states would be allowed to tax in full income attributable to the oil

which Congress exempted from the WPT, and conversely would be precluded from taxing through their own corporate net income taxes income attributable to the oil which Congress subjected to tax. Absent preemption, which plainly is not the case here, the Constitution should not be read to produce such an irrational result. Nor should the other taxpayers of New Jersey be constitutionally required to subsidize a portion of the WPT liabilities of integrated oil companies.

C. Defining A Site-Specific Cost Would Be Extremely Difficult

As pointed out above, the WPT is not a site-specific cost. The companies assume that a severance tax is site-specific, but what about a so-called state severance tax measured by the net proceeds of production?[31] Would *ad valorem* property taxes using an assessed value based on sales of comparable properties or the discounted income stream from a property be site-specific? Many states deny a deduction for other states' income taxes. *See* Appendix B. For a company doing 99% of its business in state A and 1% of its business in state B, would the income tax of state A be site-specific such that state B could not disallow it in computing the apportionable income of the corporation? Another of the federal income tax

[31] Minnesota has a tax of 2% on the net proceeds of mining, which allows a deduction for certain ordinary and necessary business expenses, depreciation, and certain exploration and development expenditures. 2 State Tax Guide, All States (CCH) ¶ 45,519. Nevada taxes the net proceeds of mining with deductions for certain costs of production, depreciation, royalties, state unemployment and social security contributions. *Id* at ¶ 45,261.

deductions disallowed under the CBT is a portion of interest paid on debt owed to 10% or more shareholders. The Solicitor General suggests that such interest is not site-specific (U.S. B21), but would that be true for mortgage interest paid with respect to out-of-state property from funds generated by the property?

D. The Rule Suggested By The Solicitor General Would Not Do Justice In Individual Cases

The Solicitor General suggests that the rule would apply only where the asserted skewing is "systemic, and not limited to particular taxpayers based on the fortuity of the locations of parts of their businesses" (U.S. B22). If the Commerce Clause "forbids discrimination . . . against interstate commerce on the specific facts of each case," *Exxon v. Maryland*, 437 U.S. at 151 (dissenting opinion), the Solicitor General's proposed rule is unacceptable. Under it an integrated oil company having all its crude oil production in Alaska, California and Texas (and thus, under the Solicitor General's and the companies' theory, its WPT "sited" in those states) could not complain if Kansas (which has crude oil) denied a deduction for the WPT. Despite the fact that, as to that taxpayer, the disallowed cost would be entirely out-of-state, there would be no impermissible skewing of the income base. Because Kansas has crude oil, the skewing would not be "systemic."

The Solicitor General's suggestion that the rule would apply only where the geographic skewing was 'of significant magnitude" and "obvious" is equally unsatisfactory. The Court has made clear that *any* discrimination against interstate commerce is unacceptable no matter how slight

and that it need not know how discriminatory a tax is before striking it down. *Maryland v. Louisiana,* 451 U.S. at 760; *Bacchus Imports,* 468 U.S. at 269. How large would the skewing have to be to violate the Constitution? Has the WPT deduction declined to such an extent due to falling crude oil prices (*see* above at 6 and Motion to Affirm at 10-11 and n.8) that it is no longer of constitutional magnitude?

The Court has long recognized the states' ability to exercise their sovereign power of taxation and the diversity of state tax schemes and has declined to prescribe uniform rules in this area. *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 444 (1940); *Portland Cement,* 358 U.S. at 457; *Moorman Mfg.,* 437 U.S. at 278-280. This policy of restraint, combined with the intrusiveness of a blanket rule prohibiting the denial of a deduction for an out-of-state cost should lead the Court to reject the companies' position as it did in *Moorman Mfg., Exxon v. Wisconsin,* and *Container Corp.,* 463 U.S. at 185-189.

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CONCLUSION

For the foregoing reasons the judgment of the Supreme Court of New Jersey should be affirmed.

Respectfully submitted,

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APPENDIX

APPENDIX A

X CORP.

PRO FORMA SEPARATE COMPANY BASIS

FORM 1120—U.S. CORPORATION INCOME TAX RETURN

		000 Omitted 1980	1981
1	Sales	$15,333,900	$17,092,900
2	Less: Cost of goods sold	10,540,300	11,644,800
3	Gross profit	4,793,600	5,448,100
4	Dividends	372,900	83,500
5	Interest on obligations of the United States and U.S. instrumentalities	6,500	500
6	Other interest	107,000	11,300
7	Gross rents	117,600	116,700
8	Gross royalties	2,400	1,600
9	(a) Capital gain net income	29,200	17,400
	(b) Net gain or (loss) from Form 4797	1,100	13,800
10	Other income	(15,500)	40,500
11	TOTAL income	5,414,800	5,733,400
12	Compensation of officers		
13	Salaries and wages	363,200	421,900
14	Repairs	517,400	603,600
15	Bad debts	4,000	
16	Rents	169,200	193,300
17	Taxes	1,234,600	1,477,700

X CORP.

Form 1120 continued—

		000 Omitted 1980	1981
18	Interest	150,800	269,900
19	Contributions	1,900	13,400
20	Amortization	2,500	2,900
21	Depreciation	461,500	596,000
22	Depletion	111,100	72,000
23	Advertising	36,800	49,600
24	Pension, profit-sharing, etc. plans	142,400	143,200
25	Employee benefit programs	5,400	5,700
26	Other deductions	1,304,700	1,724,200
27	TOTAL deductions	4,505,500	5,573,400
28	Taxable income before net operating loss deduction and special deductions	909,400	160,000
29	Less: Special deductions	366,000	75,000
30	Taxable Income	543,400	85,000
31	TOTAL TAX	67,200	5,500

X CORP.

Schedule A Form 1120, Line 2, Cost of Goods Sold

1	Inventory at beginning of year	471,800	480,200
2	Merchandise bought for manufacture or sale	9,251,600	10,577,200
3	Salaries and wages	132,900	284,800
4	Other costs	1,164,300	863,000
5	Total	11,020,600	12,205,200
6	Less: Inventory at end of year	480,200	560,400
7	Cost of goods sold	10,540,500	11,644,800

X CORP.

Form 1120, Line 17, Schedule of Taxes

	000 Omitted 1980	1981
F.I.C.A.	$ 33,800	$ 44,100
Federal Unemployment Insurance	1,300	1,300
State Unemployment Insurance	2,300	2,500
Foreign Payroll	400	100
State and Local Income Taxes	13,000	(9,300)
Franchise Taxes Measured by Income	4,300	4,300
Property Taxes	76,400	87,500
Production Taxes	154,600	230,800
Transportation Taxes	1,200	1,000
Sales and Use Taxes	14,500	62,300
General Corporate Taxes	622,400	34,600
Windfall Profit Tax	310,300	1,018,500
Total Taxes	$ 1,234,500	$ 1,477,700

X CORP.

CBT—100 NEW JERSEY CORPORATION BUSINESS TAX RETURN

Sch. A—Computation of Entire Net Income and Tax Based on Entire Net Income. Every Corporation Must Complete This Schedule. Federal Schedules Are Acceptable For Lines 1-28.

		1980	1981
Gross Income			
1	Gross receipts or gross sales	Lines 1-27. See Attached Federal Returns	
2	Less: Cost of goods sold and/or operations.		
3	Gross profits		
4	Dividends		
5	Interest on obligations of the United States and U.S. instrumentalities		
6	Other interest		
7	Gross rents		
8	Gross royalties		
9	(a) Capital gain net income (attach separate Federal Schedule D)		
	(b) Net gain or (loss) from line 11, Part II, Form 4797 (attach Federal Form 4797)		
10	Other income (attach schedule)		
11	TOTAL income—Add line 3 through 10		

Deductions

000 Omitted

		1980	1981
12	Compensation of officers (Schedule F-1)		
13	Salaries and wages (not deducted elsewhere)		
14	Repairs (Do not include capital expenditures)		
15	Bad debts		
16	Rents		
17	Taxes (Sch. H)		
18	Interest		
19	Contributions		
20	Amortization		
21	Depreciation (Attach Copy of Federal Form 4562 or Other Federal Depreciation Schedule)		
22	Depletion		
23	Advertising		
24	Pension, profit-sharing plans, etc.		
25	Employee benefit programs		
26	Other deductions (attach Schedule)		
27	TOTAL deductions—Add lines 12 through 26		
28	Taxable income before net operating loss deduction and special deductions—Line 28, Federal Form 120	$ 909,400	$ 160,000

		1980	1981
29	Interest on Federal, State and Municipal obligations	1,100	
30	Interest paid to shareholders	-0-	-0-
31	N.J. Corporation Tax	100	1,100
32	Total	910,600	161,100
33	Less: Dividend Exclusion	359,700	68,700
34	Total	550,900	92,400
35	Other Adjustments	-0-	-0-
36	Adjusted Entire Net Income	550,900	92,400
37	Allocation factor	.012877	.013564
38	Allocated net income (Line 36 x Line 37)	7,100	1,300
39	Investment company	-0-	-0-
40	Regulated Investment Company	-0-	-0-
41	Entire Net Income Tax Base	7,100	1,300
42	Entire Net Income Tax (Line 41 x 9%)	639	113

APPENDIX B

DEDUCTIONS ALLOWED UNDER STATE CORPORATE NET INCOME TAXES FOR DEPLETION, STATE INCOME TAXES, AND THE FEDERAL INCOME TAX.

Sources: *Multistate Corporate Income Tax Guide*, Vol. I (CCH); *State Tax Guide, All States*, Vol. 1 (CCH, 2nd ed.)

	Depletion	State Inc. Tx.	Fed. Inc. Tax
Alabama	Cost exc Oil & Gas @ 27½%	No	Yes
Alaska	SAF*	No	No
Arizona	Percentage but rates differ fr. Fed.	No exc Arizona	Yes
Arkansas	SAF	Yes exc Ark	No
California	SAF but modified for Oil & Gas & Sulphur	No	No
Colorado	SAF But 27½% for Oil Shale	Yes exc Colo	No
Connecticut	SAF	Yes exc Conn	No
Delaware	SAF exc Only Cost for Oil & Gas	Yes exc Del	No
Dist. of Columbia	SAF	No	No
Florida	SAF	No	No
Georgia	SAF	No exc GA	No
Hawaii	SAF	Yes	No
Idaho	SAF	No	No
Illinois	SAF	Yes exc Ill	No
Indiana	SAF	No	No
Iowa	SAF exc Cost for Oil, Gas & Geothermal	Yes exc Iowa	50%
Kansas	SAF	No	No

* "SAF" indicates that the state treatment is the "same as federal" income tax treatment.

	Depletion	State Inc. Tx.	Fed. Inc. Tax
Kentucky	SAF	No	No
Louisiana	SAF exc 22% for Oil & Gas	Yes exc La	Yes
Maine	SAF	No	No
Maryland	SAF exc Cost for Oil	No	No
Massachusetts	SAF	No	No
Michigan	SAF	No	No
Minnesota	Cost	No	No
Mississippi	Cost Limit; Percentage Computation	No	No
Missouri	SAF	No	Yes
Montana	SAF But Only Cost for NOL	No	No
Nebraska	SAF	Yes	No
Nevada	No Corp. Inc. TX		
New Hampshire	SAF	No	No
New Jersey	SAF	Yes exc NJ	No
New Mexico	SAF	Yes	No
New York	SAF	No	No
New York City	SAF	Yes exc NYS&C	No
North Carolina	Cost except for solid minerals located in No. Car., for which Fed. % depl. rules apply.	No	No
North Dakota	SAF	No	Yes
Ohio	SAF	Yes	No
Oklahoma	SAF exc 22% for Oil & Gas	No	No
Oregon	Cost exc 15% for Metal Mines	No	No
Pennsylvania	SAF	No	No

	Depletion	State Inc. Tx.	Fed. Inc. Tax
Rhode Island	SAF	Yes exc R.I.	No
So. Carolina	SAF w/ in-State Option	No	No
So. Dakota	No corp. tax on gen'l bus. corps.		
Tennessee	Cost Limit; Percentage Computation	Yes exc Tenn	No
Texas	No Inc. Tx		
Utah	SAF	No	No
Vermont	SAF	Yes	No
Virginia	SAF	No	No
Washington	No Corp. Inc. TX		
W. Virginia	SAF	No	No
Wisconsin	Cost	No	No
Wyoming	No Inc. Tx.		

Additional Explanation of State Income Tax Deduction for Depletion in Those States Where Such Deduction Differs From that Prescribed by the Internal Revenue Code of 1986.

Source: *Multistate Corporate Income Tax Guide*, Vol. 1 (CCH), except where otherwise indicated.

Alabama permits percentage depletion for oil and gas only. The rate is 27½% of gross income from the property. Cost depletion applies to all other natural deposits and timber. CCH Par. 2058.28.

Arizona allows percentage depletion on certain minerals at rates from 5% to 23% of gross income from mining but not in excess of 50% of taxable income derived from mining. The rate for oil, gas and geothermal wells is 27½% of gross income from the property also not exceeding 50% of taxable income derived from the well. CCH Par. 2152.

California follows the federal treatment except that, in the case of oil and gas wells and geothermal deposits, percentage depletion is permitted at the rate of 22% of gross income from the property not to exceed 50% of net income from the property. However, depletion of oil and gas wells, geothermal deposits and sulphur mines is subject to the following reduction: Depletion in excess of $1.5 million is reduced by 125%. The effect is to eliminate depletion when aggregate deductions total $7.5 million. CCH Par. 2258.48.

Colorado follows the federal treatment except that oil shale may be depleted at 27.5% rather than 15%. CCH Par. 2308.31.

Delaware follows the federal treatment except that only cost depletion is available for oil and gas wells. CCH Par. 2404.

Iowa follows the federal treatment of depletion except in the case of oil, gas or geothermal wells where the deduction is limited to cost depletion. CCH Par. 2802.

Kentucky follows the federal treatment for depletion purposes with a limited exception in connection with the disposal of coal and iron ore.

Louisiana follows the federal treatment except in the case of oil and gas wells where percentage depletion must be used if it results in a larger deduction than cost depletion. The rate for oil and gas wells is 22% of gross income from the property not to exceed 50% of net income before depletion. CCH Par. 2958.73.

Maryland follows the federal treatment except in the case of oil wells where only cost depletion is allowed. CCH Par. 3058.09.

Minnesota allows only cost depletion with a limited exception in the case of copper and nickel mines for tax years which began before 1987. CCH Par. 3208.39.

Although Mississippi permits percentage depletion (except in the case of timber), aggregate deductions may not exceed the cost basis of the property. The effect is to limit taxpayers to deducting the cost basis of their property but such recovery can occur more quickly than if deductions were required to be computed under the cost method. CCH Par. 3258.17.

Montana follows the federal treatment except for purposes of computing a net operating loss. The effect is to

permit taxpayers the full benefit of percentage depletion if there is sufficient taxable income in the year in which the depletion deduction arises. CCH Par. 3358.14.

North Carolina allows percentage depletion in the case of solid minerals located in North Carolina; otherwise the deduction is limited to cost depletion. CCH Par. 3708.34.

Oklahoma follows the federal treatment except in the case of oil and gas where percentage depletion at the rate of 22% of gross income not to exceed 50% of taxable income from the property, is permitted. CCH Par. 3858.06.

Oregon permits only cost depletion except in the case of metal mines which are eligible for a deduction of 15% of gross income from the property not to exceed 50% of net income from the property. CCH Par. 3904 and *State Tax Guide, All States,* Vol. 1 (CCH 2nd ed.), Par. 10-760.

South Carolina follows the federal treatment but, in addition, affords taxpayers who allocate or apportion income, the option of eliminating depletion from pre-apportionment income and deducting from South Carolina taxable income after allocation and apportionment, percentage depletion on South Carolina deposits. There must be the possibility of a greater reduction in tax because of taxpayer's in-state properties eligible for depletion. CCH Par. 4052 and *State Tax Guide, All States,* Vol. 1 (CCH, 2nd ed.), Par. 10-803.

Although Tennessee follows the federal treatment, no further deductions are allowed once the cost basis of the property has been exhausted. The effect is to limit depletion to cost basis but to permit such basis to be re-

covered more rapidly than if the cost method were employed. CCH Par. 4158.15.

Wisconsin limits taxpayers to cost depletion. CCH Par. 4502.

APPENDIX C

GROSS RECEIPTS TAX RATE ON NEW JERSEY RECEIPTS REQUIRED TO YIELD ACTUAL TAX ON APPORTIONED NET INCOME WITH NO DEDUCTION FOR WPT.

	N.J. TAX PER DIV. TXN.	1980 N.J. RECEIPTS	REQUIRED GROSS RECEIPTS TAX RATE	N.J. TAX PER DIV. TXN.	1981 N.J. RECEIPTS	REQUIRED GROSS RECEIPTS TAX RATE
Amerada Hess	$12,504,242	$1,963,980,529	.006366	$7,561,840	$2,030,427,351	.003724
Atlantic Richfield	1,633,808	351,097,761	.004653	1,309,033	494,560,373	.002646
Chevron	6,947,422	595,196,591	.011672			
Cities Service	1,618,395	430,716,383	.003757	912,204	525,071,375	.001737
Conoco	523,399	215,713,000	.002426			
Exxon	19,038,950	1,733,219,568	.010984			
Gulf	997,987	418,110,012	.002386	1,356,153	494,547,325	.002742
Mobil	2,235,947	523,179,106	.004273			
Phillips	195,684	62,178,170	.003147			
Shell	3,509,330	507,607,824	.006913	5,031,746	518,628,982	.009702
Tenneco	592,949	98,920,231	.005994			
Texaco	5,064,761	525,955,022	.009629			
Union	384,965	54,471,208	.007067			

Source: Appendix A to Appellants' brief and the companies' New Jersey CBT returns which are included in the record. The New Jersey receipts of Tenneco and Gulf for 1981 are not in the record, but both companies provided these entries and consented to their use in this Appendix.

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Nos. 87-453 and 87-464

IN THE
Supreme Court of the United States

OCTOBER TERM, 1988

AMERADA HESS CORPORATION *et al.*,
Appellants,
v.
DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,
v.
DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeals from the Supreme Court of New Jersey

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Appellee.

On Appeals from the Supreme Court of New Jersey

REPLY BRIEF FOR APPELLANTS

New Jersey asserts a sweeping power to tax multistate businesses far beyond what this Court's decisions have sanctioned. Under its theory, a state may freely single out for disadvantageous income tax treatment costs associated with any form of economic activity that is conducted exclusively outside its borders.

New Jersey and its state amici brush aside the territoriality and anti-discrimination principles that ordinarily constrain state taxing power. Territorial limitations, they say, have no bearing on income tax deductions: so long as the state adds nothing to the taxpayer's unitary gross receipts, the manner in which it allows or

disallows deductions in defining net income is constitutionally irrelevant, no matter how geographically tailored the deductions may be. NJ Br. 23-25; Iowa Br. 15-17.[1] Likewise, in their view, constitutional protections against discriminatory state taxation do not apply in this case: a state is free to impose unique tax burdens on any exclusively out-of-state activity, so long as there is no identical in-state activity that can be said to benefit from the discrimination. NJ Br. 37-41; Iowa Br. 19-27.

New Jersey's position is at war with much of this Court's Due Process and Commerce Clause jurisprudence. If, as New Jersey argues, a state may lawfully fashion its allowable tax deductions to disfavor the exclusively out-of-state activities of a multistate taxpayer, even the most rigorous enforcement of this Court's limitations on the proper scope of a unitary business, coupled with the strictest insistence upon a geographically benign apportionment formula, will be ineffective to deter the state from taxing more than its fair share of multistate net income. And if a jurisdiction may lawfully affix discriminatory tax burdens to any out-of-state activity that has no identical in-state counterpart, the free trade purpose of the Commerce Clause may easily be frustrated by the successive imposition of retaliatory tax measures that penalize taxpayers on account of their exclusively out-of-state operations.

Perhaps aware of the extravagance of its assertions, the state strains to fit this case within the Court's precedents, insisting at the outset that the issue here was decided in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). NJ Br. 10, 14-16. That venture founders, however, on a misreading of this Court's decision and a misconception of the federal Windfall Profit Tax Act. In the end, New Jersey must stand or fall on its novel and expansionist view of state taxing power.

[1] "Iowa Br." refers to the amici curiae brief filed by Iowa and 11 other states.

A. This Case Is Not *Exxon v. Wisconsin*

The question in *Exxon v. Wisconsin* was whether the state could include in Exxon's preapportionment tax base that portion of its total net income that the company's internal accounting system attributed to integrated production and refining activities conducted outside the state. The Court held that the out-of-state production and refining operations and the in-state marketing operations were part of a single unitary enterprise and that Wisconsin accordingly could tax a fairly apportioned share of the net income ultimately earned from all those operations. 447 U.S. at 224-27.

New Jersey imagines that this case presents the same issue. In its eyes, appellants want to "exempt from the New Jersey CBT a portion of their unitary net income" by using "a form of separate accounting" to exclude "a definable, separable wellhead profit." Br. 9, 18. But no party here seeks to exempt any portion of its unitary income from the New Jersey tax base, and no company argues that crude oil production or "wellhead profit" is outside the scope of its unitary business. The issue, instead, is whether the state, having incorporated in its preapportionment tax base appellants' income from all sources, including their exclusively out-of-state production activities, may selectively disallow an offsetting deduction for a discrete class of costs necessarily incurred solely on account of those out-of-state production activities.

Exxon v. Wisconsin is of no help at all to the state on that issue. While it supports the inclusion of income derived from integrated crude oil production, it provides no authority for ignoring the associated costs of crude oil production. On the contrary, the Court's analysis assumed that the unitary stream of income embraced not only company-wide revenues, as New Jersey would have it, but also company-wide costs and expenses. *See* 447 U.S. at 221. The Court has long taken for granted that the apportionment of unitary net income requires "[a]

division of revenues *and* costs" in a manner designed to "produce . . . a uniformity of net return, or a fair approach thereto." *Norfolk & Western Ry. v. North Carolina ex rel. Maxwell*, 297 U.S. 682, 684 (1936) (emphasis added).

When a state uses the unitary business method, therefore, it must take the bad with the good. It cannot include in the tax base a company's total income from all sources but then cherry-pick the costs, allowing a deduction for those incurred inside the state while disallowing a deduction for those incurred outside the state. Such disparate treatment of out-of-state costs necessarily negates the geographical "uniformity of net return" (*id.*) and thereby subverts the premise of formula apportionment.

Appellants fully accept the unitary business method in this case. We ask only that the method be applied consistently to both sides of the ledger and that out-of-state costs be treated no less favorably than in-state costs. Nothing in *Exxon v. Wisconsin* sanctions New Jersey's departure from that even-handed treatment.

B. The Windfall Profit Tax Is a Site-Specific, Out-of-State Cost

We argued in our opening brief that New Jersey's inclusion in its tax base of income derived in part from exclusively out-of-state oil production activities, together with its disallowance of an offset for WPT costs incurred solely in connection with those activities, necessarily yielded a geographically asymmetrical tax base and an impermissibly exaggerated state tax liability. The foundation of our argument was that WPT liability is incurred on account of the removal of each barrel of crude oil from the vicinity of the producing well—an activity that is both site-specific and geographically localized.

Until now, no one had disputed that premise. The New Jersey Supreme Court had acknowledged that the WPT

is "imposed on production at the wellhead rather than on . . . producers' overall net profits or income" and that "the basic measure of the windfall profit [is] the difference between the uncontrolled and controlled price of a barrel of crude oil at the point the oil [is] removed from the producing property." J.S. App. 5a-6a. New Jersey itself had conceded at the jurisdictional stage in this Court that WPT costs "have a geographic source outside the State." Motion to Dismiss or Affirm 14. And the Solicitor General, in response to this Court's invitation, had concluded that "the windfall profit tax is site-specific in the critical respect—liability for it is as directly related to activity that takes place at a geographically identifiable place as is liability for an ordinary severance tax." U.S. Br. 24.

In its merits brief, however, New Jersey argues for the first time that "the WPT is *not* a site-specific cost." Br. 24 (emphasis added). It asserts that the WPT tax base is the product of activities conducted throughout the United States and is computed based on factors unrelated to the time and place of removal. In the state's view, therefore, WPT costs are tied to no geographically isolated events, and New Jersey's disallowance of a deduction for those costs does not affect the geographical symmetry of the tax base.[2]

[2] New Jersey's shift of position is part of a wholesale repudiation of both its own arguments below and the analysis underlying the state Supreme Court's statutory holding. New Jersey conceded in the state courts that the WPT is "imposed when crude oil is removed from a producing property." NJ App. Br. 17. The state's theory was that the WPT is nevertheless a tax on "income or profits" within the scope of the add-back provision, because "realization [of income] occurs upon the lifting of oil from the ground," even if no sale occurs at that point. *Id.* at 75. *See* J.S. App. 25a (describing the state's position). The New Jersey Supreme Court likewise concluded that the WPT, though "imposed on production at the wellhead," qualifies as a tax on income or profits because "oil production income is realized [at the wellhead] when the oil is lifted." J.S. App. 5a, 29a. The site-specific nature of the WPT was of no constitutional concern to New Jersey in the state courts. It argued, and the state Supreme Court held, that income tax deductions are

The state's new theory rests on a mistaken understanding of the federal statute.

1. *"Windfall Profit" Is Not a Component of Net Income*

The state's principal contention is that "windfall profit," as defined by Congress, is part of what the state calls the "decontrol element" of net income—by which it means the portion of net income attributable to the termination of federal crude oil price controls. Br. 10, 15-16, 39 n.26. The state believes, therefore, that "windfall profit" is "no different in character" from bottom-line corporate net income. Br. 11. Because the measure of the WPT is a component of unitary net income, under New Jersey's thesis, and because unitary net income is derived from corporate activities everywhere, including "the companies' activities in New Jersey" (Br. 12), the state concludes that the WPT is no more site-specific than any other tax on net income and cannot be attributed solely to crude oil production activities.

New Jersey's analysis is grounded on a colloquial understanding of the term "windfall profit" that bears no

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beyond constitutional scrutiny regardless of where the costs at issue are incurred. J.S. App. 33a-34a.

In a remarkable eleventh-hour turnabout, New Jersey now asserts —directly contrary to its own arguments below and the state Supreme Court's holding, but without a word of explanation—that "the companies realize *no* income until their crude oil has been sold" and that "the WPT is *not* site specific" but is affected by the producer's income-generating activities everywhere. Br. 22, 26 (emphasis added). New Jersey cannot have it both ways. If, as the state successfully argued below, the WPT is a wellhead tax on "income" "realized" upon lifting, the tax is indeed a site-specific cost of exclusively out-of-state crude oil production, and disallowance of a deduction geographically skews the tax base. If, as the state now argues in this Court, income is realized not upon lifting but only upon sale, the WPT, because it is imposed at the wellhead, is taxing something other than "income or profits" within the meaning of the add-back provision as construed by the New Jersey Supreme Court.

resemblance to the statutory definition. Under I.R.C. § 4988(a), "the term 'windfall profit' means the excess of the removal price of the barrel of crude oil over the sum of—(1) the adjusted base price of such barrel, and (2) the amount of the severance tax adjustment with respect to such barrel . . . ." The definition has nothing to do with the producer's net income or with any "decontrol element" of net income. As the New Jersey Supreme Court recognized (J.S. App. 5a-6a), "windfall profit" is keyed entirely to the incremental value of each barrel of crude oil at the point of removal and is not affected by a producer's "overall net profits or income."

New Jersey confuses the Windfall Profit Tax enacted by Congress with a classic wartime "excess profits tax." The excess profits taxes typically imposed an additional high rate of tax on a portion of corporate net income in excess of a base amount.[3] If Congress had followed that model in enacting the WPT, this would be a different case.

But Congress considered and expressly rejected that model, concluding that "an excise tax is a far simpler approach to taxing windfall profits than an excess profits tax, such as was used during World War II and the Korean War." H.R. Rep. No. 304, 96th Cong., 1st Sess. 7 (1979). It accordingly chose to "impos[e] the windfall profit tax on only one event"—removal of a barrel of crude oil from the producing premises—rather than

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[3] *See* Revenue Act of 1917, Pub. L. No. 64-377, § 201, 39 Stat. 1000, 1000-01 (imposing an excess profits tax on the amount of corporate "net income" that exceeded the sum of $5,000 plus a percentage of actual capital invested); War Revenue Act of 1917, Pub. L. No. 65-50, §§ 200-214, 40 Stat. 300, 302-08 (imposing a similar "war excess profits tax"); Revenue Act of 1934, Pub. L. No. 73-216, § 702, 48 Stat. 680, 770-71 (imposing an excess profits tax on the portion of corporate "net income" that exceeded a percentage of the declared value of capital stock); Excess Profits Tax Act of 1940, Pub. L. No. 76-801, § 201, 54 Stat. 974, 975-98 (imposing an additional tax on the amount of "net income" that exceeded a percentage of base period net income adjusted by a percentage of net capital additions or reductions); Excess Profits Tax Act of 1950, Pub. L. No. 81-909, § 101, 64 Stat. 1137-1216 (similar to 1940 Act).

on aggregate net income derived from all "stages of production and distribution." *Id.* at 43; *accord* S. Rep. No. 394, 96th Cong., 1st Sess. 66 (1979).[4]

Despite its title, therefore, the tax that Congress enacted "is not a tax on profits." Robison, *The Misnamed Tax: The Crude Oil Windfall Profits Tax of 1980,* 84 Dick. L. Rev. 589 (1980). It is a tax on wellhead value. Like a typical severance tax, the WPT is imposed and measured as of the time and place of removal. In the New Jersey Supreme Court's words, "the value of the oil" (and consequently the statutory windfall profit) is fixed "at the point of lifting," regardless of "[l]ater events." J.S. App. 29a. "The fact that the posted price may fall subsequent to the lifting of the oil or that some barrels may be lost following severance from the lease is irrelevant." *Id.* at 28a-29a. Contrary to the state's new position in this Court, the producer's WPT liability, like its severance tax liability, neither depends on nor fluctuates with the amount of its unitary net income or any "decontrol element" of net income.

The state amici, tracking New Jersey's misguided argument, assert that "the WPT is associated with the profitability of the entire unitary business" and that "windfall profit is earned, in part, as a result of Appellants' New Jersey marketing activities." Iowa Br. 7, 17. Unlike New Jersey, the amici ultimately acknowledge, albeit grudgingly, that "the windfall profit is superficially deemed by Congress to occur upon 'removal' at the production site." *Id.* at 14. They nonetheless invite the

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[4] The Senate specifically considered a proposed floor amendment modeled on the wartime excess profits taxes. The amendment—described by its author as "a genuine windfall profit tax" (125 Cong. Rec. 35,230 (1979) (statement of Sen. McClure))—would have imposed on each "petroleum industry corporation" a surcharge tax of 90 percent on that portion of its net income that yielded a rate of return on capital investment in excess of the average rate of return for all manufacturing corporations. *Id.* at 35,229-30. After extensive debate, the amendment was rejected. *Id.* at 35,240-41.

Court to disregard the "structural form of the WPT"—in other words, the statutory text—and to focus instead on what amici consider the "economic reality . . . that the WPT was imposed upon the anticipated decontrolled revenues, in part due to Appellants' sales activities in New Jersey and elsewhere." *Id.*

Although Congress anticipated that producers would receive additional revenues and earn additional profits as a result of decontrol, it decided to impose a tax at the point of removal and to make downstream revenues and earnings irrelevant to WPT liability. Contrary to the state amici's approach, what matters here is the tax that Congress actually enacted, not general legislative aspirations or shorthand characterizations unembodied in the text of the statute.

2. *The Computation of the WPT Does Not Affect its Site-Specific Incidence or Measure*

New Jersey argues alternatively that the WPT cannot be site-specific "because its computation depends on many factors having nothing to do with the property where the oil is produced." Br. 12. But none of the "factors" to which the state points—"the removal price, inflation adjustment, and net income limitation" (Br. 26)—affects the fundamental character of the WPT, recognized even by the New Jersey Supreme Court, as a tax measured by the incremental value of each barrel of crude oil "at the point the oil was removed from the producing property." J.S. App. 6a.

a. *Removal price.* New Jersey's main point is that, in those rare instances when there is no representative field or market price for crude oil—Alaska North Slope crude oil is the only example it cites—a producer may have to compute its removal price by starting with a downstream value and then subtracting out the transportation and other post-removal costs incurred to reach that downstream point. Br. 26-29. Those costs are subtracted, however, not because they are *part* of the WPT base, but for precisely the opposite reason—they are *extraneous* to the WPT base and must be eliminated to deter-

mine the value of the crude oil as of the time and place of its removal.

Except in the case of third-party sales at the wellhead, the removal price of a barrel of crude oil is determined by reference to "the constructive sales price for purposes of determining gross income from the property under section 613." I.R.C. § 4988(c). It has long been the rule under section 613 and its predecessors that "gross income from the property" must be determined at the wellhead—"before conversion or transportation" (Treas. Reg. § 1.613-3(a))—and that value added to the mineral after removal from the vicinity of the well, including the cost of transporting the mineral to market, may not be considered in determining the proper wellhead value. *E.g.*, *United States v. Cannelton Sewer Pipe Co.*, 364 U.S. 76, 81-89 (1960); *Hugoton Production Co. v. United States*, 349 F.2d 418 (Ct. Cl. 1965) (Justice Reed, sitting by designation); *Consumers Natural Gas Co. v. Commissioner*, 78 F.2d 161, 162-63 (2d Cir.) (L. Hand, J.), *cert. denied*, 296 U.S. 634 (1935); Rev. Rul. 75-6, 1975-1 C.B. 178.

New Jersey therefore has it exactly backwards when it says that for purposes of the WPT crude oil is "valued based on factors far distant from the wellhead." Br. 29. It is to ensure that crude oil will *not* be valued based on such factors that producers must disregard them in calculating the removal price.

It may be true, as New Jersey states, that the value of crude oil at the time and place of removal is affected by "the price that refiners . . . are willing to pay for the oil" in distant markets. Br. 29. But that hardly proves that a tax measured by wellhead value is not a site-specific cost. The value of goods at a particular location may be influenced or even determined by a distant sale, without losing its character as a purely local measure of value. In *American Manufacturing Co. v. City of St. Louis*, 250 U.S. 459 (1919), for example, the Court upheld a license tax measured by the value of goods

manufactured locally, even though the local value was defined by the proceeds from subsequent sales of the goods in out-of-state markets.

Under New Jersey's contrary theory, even a state severance tax, measured by the wellhead value of crude oil at the time and place of severance, would not be a site-specific cost, because the measure of the tax, just as in the case of the WPT, would be affected by the price paid for crude oil in markets far from the wellhead. But if anything is clear, it is that a tax measured by wellhead value can be imposed only by the state within which the well is located, because that state and no other can have the necessary taxing relationship with that geographically site-specific value. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617 (1981); *see Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 156-57, 158-59 n.26 (1982).

b. *Inflation adjustment*. Congress sought to tax only the increased value of a barrel of crude oil attributable to price decontrol. "Since regulated prices were adjusted for inflation, if the base prices for [windfall profit] tax purposes were left unadjusted, the tax base would accrue an element clearly unrelated to decontrol." Drapkin & Verleger, *The Windfall Profit Tax: Origins, Development, Implications*, 22 B.C.L. Rev. 631, 661 n.133 (1981). The statute accordingly provided for quarterly adjustments to the "base price" of crude oil to take account of inflation. I.R.C. § 4989(a), (b).

New Jersey believes that, because "[p]rice inflation in the general economy is plainly not tied to a single oil producing property" (Br. 30), neither the adjusted base price nor the WPT itself can be considered site-specific. But the state again misses the point: the inflation adjustment was designed to *remove* "inflation in the general economy" from the tax base so that it would not affect the producer's WPT liability.

The inflation adjustment has no bearing on the WPT's operating incidence (the removal of a barrel of crude oil) or its measure (the incremental value of that barrel at

the point of removal), both of which are inseparable from the specific producing premises. If a production state imposed a severance tax measured by the wellhead value of each barrel of crude oil in excess of a $1 base, subject to a quarterly inflation adjustment, the tax would be no less tied to the site-specific activity of severance than if there were no base or no inflation adjustment. The conclusion is the same in the case of the WPT.

c. *Net income limitation.* The state argues that the NIL, which places an upper limit on WPT liability for barrels removed from high-cost properties, "is not a site-specific computation." Br. 30. But the starting point for computing the NIL, like that for computing the removal price, is the actual or constructive sales price of the crude oil in the immediate vicinity of the producing well. *See* I.R.C. § 4988(b)(3)(A); Treas. Reg. §§ 1.613-3(a), 1.613-5(a). It is immaterial, for the reasons discussed above, that the value of crude oil at the wellhead may be affected by such "off-site factors" as "the value of the oil in the market where it is refined and transportation costs." NJ Br. 30.

Nor does it make any difference that, in computing the NIL, the taxpayer deducts from the gross value of crude oil at the producing property certain expenses, including overhead, attributable to the particular property. First, the calculation is made separately for each barrel from each property, and losses on one property do not offset gains on another. Treas. Reg. § 51.4988-2(b)(1); *see Shell Oil Co. v. Commissioner*, 89 T.C. 371, 397-98 (1987). "Net income" for purposes of the NIL is thus itself a site-specific concept that relates solely to oil producing properties outside New Jersey. It is neither part of nor derived from a producer's unitary net income. On the contrary, notwithstanding the operation of the NIL, a producer may have substantial WPT liability in a particular year even though it has no net income for federal income tax or financial reporting purposes.[5]

[5] In tax year 1981, for example, Cities Service Company had no federal taxable income but more than $316 million of windfall profit tax liability. App. Div. Jt. Appendix for Plaintiffs-Appellants 642a, 657a; App. Div. Confidential Appendix for Defendant-Appellee 61a; *see* Appendix A to our opening brief, at 1a.

Second, the NIL operates only as a circuit-breaker to ensure that the WPT does not induce a producer to shut in high-cost wells. *See Shell Oil Co.*, 89 T.C. at 385; S. Rep. No. 394, *supra*, at 29. Congress viewed the NIL as "an alternative to establishing a special category under the tax for marginal properties." Staff of Jt. Comm. on Taxation, 96th Cong., 1st Sess., *The Design of a Windfall Profit Tax* 29 (Jt. Comm. Print 1979). It is thus inaccurate to imply that the NIL defines the base of the WPT. The NIL caps the effective rate of the WPT by limiting the base for some barrels produced from certain properties. But the limit applies to a base composed of site-specific values, and its application does nothing to alter the essential quality of the WPT as a tax on the removal of crude oil from specific locations outside New Jersey.

C. Geographical Tailoring of Deductions Impermissibly Distorts the Tax Base

In response to the examples in our opening brief (pp. 24-25, 28), New Jersey concedes that it could not lawfully inflate the numerator of an integrated oil company's payroll fraction, that it could not exclude oil production property from consideration in the company's property fraction, and that it could not magnify the income derived from exclusively out-of-state oil production activity in computing the company's preapportionment tax base. NJ Br. 25. "Any of these adjustments," the state admits, "would artificially augment [the company's] business income by factors bearing no relation to economic reality." *Id.* The state nonetheless argues that it may selectively disallow a deduction for exclusively out-of-state oil production costs, because the resulting base, though geographically unbalanced, is "economically real." *Id.*

If we correctly understand the argument, New Jersey still believes, as it contended at the jurisdictional stage (Motion to Dismiss or Affirm 15), that the territorial

limitations on its taxing power require only that it use a fair apportionment formula and that it include in the preapportionment tax base no more than 100 percent of the taxpayer's "economically real" unitary gross receipts. In the state's view, any adjustments that it makes to the base below that maximum are beyond constitutional challenge. As New Jersey reminds us, "there is no single definition of taxable income." NJ Br. 17. The amici put the argument more bluntly: "Deductions are a matter of grace . . . which the legislature can disallow as it chooses." Iowa Br. 16. In their view, "[a] State is not required to allow deductions for expenses of doing business, regardless of where those expenses may be incurred." *Id.*

We agree that the federal constitution prescribes no uniform definition of net income for state tax purposes. But it does require geographical neutrality. Even New Jersey acknowledges that it may not, consistent with constitutional limitations, geographically distort the preapportionment tax base by adding phantom income. Br. 25. It should have no greater license to achieve the identical result indirectly by geographically tailoring the allowable deductions. Notions of legislative grace provide no immunity from constitutional scrutiny when the state exercises its taxing discretion in a geographically disparate fashion. That is as true in the case of New Jersey's disallowance of a WPT deduction as it was in the case of New York's geographical tailoring of tax credits in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984).

D. Discrimination Against an Out-of-State Business Activity Is Unlawful Even If There Is No Identical In-State Counterpart

New Jersey's position on discriminatory taxation is straightforward: there can be no discrimination against an out-of-state business activity unless an identical in-state activity is treated more favorably. Br. 13, 39. Under that theory, if a particular form of economic activity is conducted only outside the taxing jurisdiction, the constitutional protections against tax discrimination have no application, and the state is free to impose whatever special burdens it may choose on any in-state taxpayer that happens to engage in the disfavored out-of-state activity.

We showed in our opening brief (pp. 43-45) why that constricted view of the Commerce Clause would nullify its animating purposes. The brief of amici curiae Committee on State Taxation ("COST") *et al.* treats the issue in greater depth, demonstrating persuasively that "the dangers inherent in the New Jersey taxation scheme are precisely those at which the Commerce Clause was directed: 'economic Balkanization;' disproportionate burdening of out-of-state activities; and obstruction of the 'national free trade area.'" COST Br. 11. New Jersey's brief barely responds to these points.

First, New Jersey argues that Congress, not the state, singled out crude oil producers when it imposed the WPT. Br. 12, 34. But under the Commerce Clause it should not matter whether an industry's geographically localized costs are imposed by federal statute, by state statute, by geological happenstance, or by operation of the economy. The question in each case is whether those costs may be accorded less favorable tax treatment by reason of their association with an activity performed only outside the particular taxing jurisdiction.

Second, the state asserts that the discrimination at issue here "is not drawn along state lines" but reflects a "facially neutral" distinction based "on the nature of the companies' businesses." Br. 12, 13, 37-38. It is true that the New Jersey add-back provision, as construed below, does not expressly single out "non-New Jersey" WPT costs. But facial neutrality is no defense if the effect of a state statute is to allocate tax burdens in a geographically discriminatory fashion. *American Trucking Ass'ns v. Scheiner*, 107 S. Ct. 2829, 2839 (1987). Because no oil is produced in New Jersey, no WPT costs are incurred there. Limiting the add-back provision to "non-New Jer-

sey" WPT costs would therefore be redundant. Even without an express reference to state lines, the provision operates to disfavor a class of exclusively out-of-state costs.

To say that the discrimination is based solely on the nature, not the location, of the taxpayers' businesses is likewise meaningless. Classifying taxpayers generically rather than geographically does not shield an otherwise discriminatory taxing scheme if the generic distinction relates, as it does in this case, to an exclusively extrastate feature of the disfavored class's business.

Third, New Jersey says that the Commerce Clause is not offended because the add-back provision "does not have the tendency to force comparable out-of-state activities to be performed in-state." Br. 39. As the Solicitor General stated, however, the provision could nonetheless "create an incentive to shift resources away from the out-of-State cost-producing activity . . . and into an activity that [does] not incur the special tax burden—perhaps an in-State activity," thereby distorting "[e]fficiency-based business decision-making." U.S. Br. 18-19.

More important, by imposing local tax burdens disproportionately on out-of-state activities, New Jersey is "granting to those conducting activities in the State a reduced-fare (if not a free) ride for the benefits of state government." *Id.* at 18. The measure of that reduced fare in this case is the amount of additional tax revenue that New Jersey raises by adding back WPT costs. Interstate commerce may be made to pay only its fair share, not a disproportionate share, of the local tax burden. *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 107 S. Ct. 2810, 2820 (1987). The add-back provision operates impermissibly to tax one segment of interstate taxpayers more heavily than all other taxpayers solely on account of an out-of-state activity that is integral to their interstate business.

Finally, New Jersey dismisses the threat of retaliatory taxation by pointing to several production states among

the amici curiae supporting its position in this Court. Br. 40-41. But one can as easily draw the opposite inference. The amici argue broadly that states may impose special tax burdens on the exclusively out-of-state economic activities of in-state taxpayers. Iowa Br. 19-27. The fact that other states thirst for the same expansive authority that New Jersey claims for itself reinforces rather than diminishes the risk that retaliatory taxes—and non-retaliatory taxes designed simply to export the local tax burden—will proliferate if states are empowered to enact them.

E. Geographical Neutrality Is as "Workable" for Income Tax Deductions as for Apportionment Formulas

New Jersey warns that exposing state income tax deductions to the same test of geographical neutrality that applies to apportionment formulas will "create a legal nightmare." Br. 13. But the state's alarmism is out of place here for two reasons.

First, the circumstances in this case present none of the close questions to which New Jersey adverts. As the Solicitor General put it, this is a "stark" case: it involves "a cost that is incurred exclusively out-of-State" and results in "geographic skewing that is pronounced and systemic." U.S. Br. 22. New Jersey's unfavorable treatment of WPT costs necessarily distorts the preapportionment tax base, and exaggerates the New Jersey tax liability, of *every* affected taxpayer. The Court need not resolve here the different issues that might arise if the disfavored costs included both in-state and out-of-state components and if the state's disallowance affected the geographical balance of some taxpayers' tax bases in a manner disadvantageous to the taxing state.

Second, the supposedly intractable problems hypothesized by the state are not nearly as difficult to solve as it imagines. For example, although real property taxes (NJ Br. 13, 44-45) are plainly site-specific costs, they are also ubiquitous. A state may deny a deduction for real prop-

erty taxes without creating an intrinsic asymmetry in its income tax base, as long as it treats out-of-state property taxes no differently from in-state property taxes. Similarly, there is no reason to suppose that interest payments on debt owed to 10 percent or greater shareholders (NJ Br. 18, 45) are any more likely to have a geographical source outside rather than inside any particular state. Disallowing a deduction for such payments is therefore presumptively even-handed and creates no inherent geographical bias in the tax base.

Likewise, while percentage depletion and intangible drilling costs (NJ Br. 13, 42-43) are associated with site-specific mineral production activities, a non-production state may depart from the federal treatment without offending geographical neutrality. It need only treat the capital costs of out-of-state mineral production with no less favor than it treats the capital costs of in-state industries. On the other hand, if a state with no refineries were to single out refining costs for disallowance (NJ Br. 13, 42), every out-of-state refiner's tax base would necessarily be skewed geographically, and the circumstances would therefore be comparable to those presented in this case.

New Jersey has conceded that it may not disfavor crude oil production by adjusting the three-factor apportionment formula in a geographically uneven manner. Br. 25. There is no reason to suppose that a rule of geographical neutrality is likely to be any more unmanageable when applied to income tax deductions than when applied to apportionment formulas.

This Court has always been cautious in defining the constitutional limitations on state taxing power. It has "counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977). But the Court has never done what New Jersey asks it to do here: sanction a new species of extraterritorial taxation, and a

novel form of discrimination against out-of-state business, for fear that forbidding it might lead to future litigation over other state tax mechanisms. New Jersey has not explained why the Court should forgo its historical "case-by-case approach" (*id.*) or suspend the operation of ordinary jurisprudential principles as applied to the "unique characteristics" and "particular circumstances" (*id.*) of this case.

CONCLUSION

For the reasons stated above and in our opening brief, the judgment of the Supreme Court of New Jersey should be reversed.

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SEPTEMBER 1988

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Nos. 87-453 and 87-464

In the
Supreme Court of the United States

October Term, 1987

AMERADA HESS CORPORATION, et al.,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

Brief of the Committee on State Taxation of the Council of State Chambers of Commerce, the National Association of Manufacturers and the Chamber of Commerce of the United States as Amici Curiae in Support of Jurisdictional Statements of Appellants

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Brief of the Committee on State Taxation of the Council of State Chambers of Commerce, the National Association of Manufacturers and the Chamber of Commerce of the United States as Amici Curiae in Support of Jurisdictional Statements of Appellants

Introductory Statement

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce, the National Association of Manufacturers and the Chamber of Commerce of the United States of America as *amici curiae* in support of the jurisdictional statements filed by appellants in the above-captioned cases. Written consents of the appellants and the appellee have been obtained and filed with the Clerk of the Court.

Interest of Amici Curiae

The Council of State Chambers of Commerce ("COUNCIL"), organized in 1932, consists of 42 Chambers of Commerce. The Committee on State Taxation ("COST"), one of the three advisory committees of the COUNCIL, consists of 262 corporate members which conduct a substantial portion of the interstate commerce of United States taxpayers. One of COST's principal activities has been to work with the states and others toward developing fair and equitable standards of state taxation.

The National Association of Manufacturers of the United States of America ("NAM") is a non-profit, voluntary business association incorporated under the laws of the State of New York. The NAM represents more than 13,000 companies, large and small, located in every state. Further, NAM is affiliated with an additional 158,000 businesses through the Associations Council and the National Industrial Council. The membership of the NAM represents an estimated 80 percent of all goods manufactured in the United States.

The Chamber of Commerce of the United States ("Chamber") is the largest federation of business organizations and individuals in the United States. Current Chamber membership includes more than 180,000 corporations, partnerships and proprietorships, as well as several thousand trade associations and state and local chambers of commerce. The Chamber regularly advocates its members' views in court on issues of national concern to the American business community.

Member companies of COST, NAM and the Chamber are representative of that part of the nation's business sector which is most directly affected by state taxation of interstate operations. These members include most of the appellants and other oil companies, as well as companies engaged in a diverse range of manufacturing, retailing and financial pursuits.

COST, NAM and the Chamber are, therefore, vitally interested in cases such as this one which present issues significantly affecting state taxation of interstate commerce.

Summary of Argument

This case challenges New Jersey's novel approach to an old dilemma: how to increase state revenues without burdening local taxpayers. New Jersey's approach is to define the net income of multistate businesses so as to disallow the deduction of a particular expense which *cannot* be incurred in New Jersey, the expense of the windfall profit tax. This "definition" violates the Due Process, Commerce and Equal Protection Clauses because it singles out out-of-state activities for disfavored treatment and results in a disproportionate allocation of taxpayers' apportionable income to the taxing state. More importantly, this case warrants plenary review because the New Jersey approach establishes a model which any state seeking to impose a disproportionate share of its tax burden on value earned elsewhere may seek to emulate.

Argument

I. This Case Warrants Plenary Review.

Faced with the ubiquitous pressures to increase state revenues while not incurring the wrath of local voters and taxpayers, states have often yielded to the temptation to impose a disproportionate share of their tax burden on out-of-state activities. *See, e.g., American Trucking Ass'n's, Inc.* v.

Scheiner, 107 S. Ct. 2829 (1987); *Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388 (1984); *Austin* v. *New Hampshire*, 420 U.S. 656 (1975); *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931); *Travis* v. *Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920).

States have taken a number of different approaches in their attempts to tax extraterritorial values: New York allowed personal exemptions from the state income tax on residents' returns only, *Travis, supra* at 79; North Carolina adopted an apportionment formula which imposed a tax burden on interstate businesses vastly out of proportion to their activities in North Carolina, *Hans Rees' Sons, supra* at 135-36; New Hampshire imposed an income tax on only those people who worked in New Hampshire but lived (and voted) elsewhere, *Austin, supra* at 659; New York disallowed certain tax credits in a manner which discriminated against business operations in other states, *Westinghouse, supra* at 400; and Pennsylvania imposed a flat tax on all trucks which, while facially neutral, had the effect of subjecting interstate vehicles to higher average taxation per mile than Pennsylvania vehicles, *American Trucking, supra* at 2844, 2847. In each of these cases and numerous others, this Court has rejected state efforts to tax a disproportionate or discriminatory share of out-of-state revenues.

The New Jersey tax in dispute here represents a novel means towards the same unlawful end. The New Jersey Corporation Business Tax ("CBT"), N.J. Stat. Ann. § 54:10A-1 *et seq.* (West 1986), acts as a tax on extraterritorial value through the state's definition of "entire net income" subject to apportionment. For purposes of determining the tax owed by a unitary, multistate business, New Jersey uses a seemingly-orthodox formula apportionment method which can be illustrated as follows:

"entire net income" subject to apportionment	×	3-factor apportionment formula	=	New Jersey taxable income.

N.J. Stat. Ann. § 54.10A-6 (West 1986).

The twist comes in the definition of "entire net income" subject to apportionment: New Jersey adopts the definition of entire net income from the federal return, meaning that, in general, business expenses allowable for federal tax purposes are allowable for determining the entire net income subject to apportionment. N.J. Stat. Ann. § 54.10A-4(k) (West 1986). Strikingly, however, a taxpayer may not deduct the expense of the crude oil windfall profit tax of 1980, 26 U.S.C. § 4986 *et seq.*[1] The CBT thus disallows an indisputably legitimate business expense, which, *by virtue of geological fact*,[2] can arise only in connection with out-of-state activity. By defining "entire net income" subject to apportionment to include the expense of the windfall profit tax, New Jersey has found a new source of revenue through the taxation of an expense which *cannot* arise in connection with in-state activity by virtue of the undisputed fact that there is no crude oil production in

[1] For the sake of simplicity, windfall profit tax expenses are referred to herein as a "deduction" in the sense that, for federal income tax purposes, they are subtractable from either gross receipts or gross income. Technically speaking, the windfall profit tax is generally treated as an inventoriable cost under I.R.C. § 471, meaning it is subtracted from gross receipts in computing gross income, rather than deducted from gross income in computing taxable income. There are also circumstances in which the windfall profit tax may be reclassified and deducted from gross income as an "ordinary and necessary" business expense under I.R.C. § 162 or as a tax under I.R.C. § 164. Regardless of whether the taxpayer treats the tax as an inventoriable cost, a business expense or a tax, however, the net effect on the calculation of taxable income is the same.

[2] New Jersey has no proven reserves of crude oil, and, consequently, no production of crude petroleum. U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

New Jersey. Thus, the plain effect of this "definition" of entire net income is to disallow the deduction of a particular expense which can arise only outside of New Jersey, thereby increasing state revenues without placing any increased burden on local activities.[3]

The beauty of New Jersey's method — from the perspective of the state tax collector — is its appearance of being squarely within the bounds of allowable state discretion. It is now understood that a state is entitled to tax its fairly-apportioned share of the entire net income of a multistate, unitary business, wherever that income was earned. *Exxon Corp.* v. *Dep't of Revenue*, 447 U.S. 207, 219 (1980). New Jersey thus maintains that it is merely exercising its discretion to *define* entire net income as it sees fit, and that, so long as it is merely exercising that discretion, it is entitled to discriminate unabashedly against out-of-state activity.

Through the "definition" of entire net income subject to apportionment, New Jersey has seemingly discovered the solution to the age-old dilemma of how to increase state revenues without burdening local business: by excluding the allowance of a deduction that, of necessity, can arise only from out-of-state activity,[4] New Jersey will raise an approximately $98 million in taxes[5] without increasing the tax burden on in-state activity by one penny.

[3] Unlike Minnesota and Wisconsin, whose tax codes contain explicit provisions disallowing deduction of the windfall profit tax, *see* Appendix G to Jurisdictional Statement filed by Amerada Hess Corporation appellants, New Jersey's disallowance was effectuated through a ruling of the state's highest court which determined, as a matter of state law, that the windfall profit tax is a tax on "profits or income" and, as such, not deductible as a matter of state law. Needless to say, for purposes of constitutional analysis, state law as set forth by the state's highest court is as subject to challenge as would be an identical law enacted by the legislature.

[4] *See* n.2, *supra*.

[5] *New Jersey Budget Message and Taxpayers' Guide, Fiscal Year 1987-1988*, at 11 (Feb. 2, 1987).

The issue presented on this appeal is by no means limited to the State of New Jersey or the windfall profit tax. All state legislatures are subject to the same pressures to increase services without increasing taxes on local business and local voters. If New Jersey can increase its revenues without burdening local activity by the simple expedient of redefining the meaning of "entire net income," each of her sister states can attempt to follow suit. Any observant state legislator can note which activities conducted by multistate businesses are not conducted in-state, and propose a revision of the state tax code which would disallow deductions in connection with those activities.

The most obvious targets of the New Jersey-type approach are severance taxes. Severance taxes, like the windfall profit tax, are a substantial cost of doing business for companies engaged in the mining or development of natural resources. Following New Jersey's lead, it would be an easy matter for states lacking in natural resources to add a line to their tax codes providing that businesses shall calculate their entire net income subject to apportionment without deducting severance taxes. For example, New Hampshire, which was recently rebuffed in its efforts to impose an income tax on non-residents only, *Austin* v. *New Hampshire*, 420 U.S. 656 (1975), has no crude oil reserves.[6] All petroleum products sold in New Hampshire must be manufactured from crude oil from other states. By precluding multistate businesses from recognizing petroleum severance taxes as a business expense, New Hampshire could attempt to raise its revenues without imposing any additional taxes on New Hampshire residents, thus accomplishing through a different means the very goal sought by the "commuter tax" struck down in *Austin*. As a matter of geological fact, the incidence of such a revision in the tax code would necessarily fall on business activity outside of New Hampshire.

[6] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

The New Jersey approach presents similar possibilities for tax code manipulation with respect to virtually any natural resource. Coal-producing companies, for example, pay to the United States Treasury $1.10 per ton of underground coal mined for the black lung disability trust fund excise tax, I.R.C. § 4121. If the states were free to refuse to recognize coal excise taxes as deductible business expenses, just as New Jersey has refused to recognize the windfall profit tax as a deductible expense, they would, in effect, be permitted to assess a tax on $1.10 per ton of coal that was never actually earned. Whatever constitutional leeway the states may have, as an abstract matter, to define allowable business deductions, a "definition" which would exclude coal excise taxes must be a legitimate subject of constitutional scrutiny when promulgated by states which, as a matter of well-known and documented fact, have no coal. The Court is not compelled to close its eyes and assume that a state must have had *some* non-discriminatory rationale for defining income in a manner that patently discriminates against out-of-state businesses; to the contrary, a "tailored" tax is to receive the "careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce," because a tailored tax "creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 288-89 n.15 (1977).

Nor are the risks of the New Jersey approach presented only to companies that pay natural resource extraction taxes. Any readily-observable difference between the states can offer the tax code drafter a similar opportunity. For example, local businesses located in landlocked states have no occasion to pay the harbor maintenance trust fund excise tax, I.R.C. § 4461, which is assessed as a percent of the value of commercial cargo loaded or unloaded at United States ports. Under

New Jersey's approach, such states may perceive themselves as being at liberty to direct multistate businesses to "add back" harbor maintenance taxes when calculating net income subject to apportionment.

Moreover, if New Jersey is free to preclude multistate businesses from recognizing tax payments as deductions from net income on a geographically disproportionate basis, then states may argue that it is equally permissible for a state to single out any deduction, however disproportionate its incidence, and preclude taxpayers from deducting that expense from the calculation of income. This possibility opens a whole range of opportunities for geographic discrimination and extraterritorial taxation.

To take a few examples, local businesses in states with little heavy industry incur few expenses for pollution controls. If such states were permitted to disallow from the calculation of net income all expenses in connection with pollution abatement, the necessary result would be to increase taxable income of multistate businesses while barely affecting the tax burdens on local industry.[7] Similarly, states which contain no facilities for the manufacture of automobiles may seek to disallow expenses related to automobile manufacture, with full confidence that the increased revenues would come entirely from business operations elsewhere.

The danger of the New Jersey-type of geographic discrimination affects not only individual taxpayers but, more importantly, the federal system as a whole, because it encourages endless rounds of retaliation between the states, as taxpayers who feel unfairly burdened by geographically-tailored defini-

[7] By way of comparison, pollution abatement capital expenditures by manufacturers in 1983 were less than $2 million in states such as Hawaii, New Hampshire and Wyoming, compared to over $90 million in the same year in the heavily-industrialized states of Ohio and Pennsylvania. U.S. Department of Commerce, *State and Metropolitan Area Data Book* 549 (1986).

tions of income encourage their home states to respond in turn by disallowing deductions which are incurred in the offending states:

> Since nonresidents are not represented in the taxing State's legislative halls, . . . judicial acquiescence in taxation schemes that burden them particularly would remit them to such redress as they could secure through their own State; but 'to prevent [retaliation] was one of the chief ends sought to be accomplished by the adoption of the Constitution.'

Austin v. *New Hampshire*, 420 U.S. 656, 662 (1975), *quoting Travis* v. *Yale & Towne Mfg. Co.*, 252 U.S. 60, 82 (1920).

Thus, for example, if there is no constitutional barrier to New York, which has no coal production,[8] defining net income such that coal severance taxes are not deductible, then the coal-producing companies would have no recourse but to turn to their home legislatures and request the disallowance of tax expenses which are peculiarly incidental to New York, such as stock transfer taxes.[9]

The above-described scenarios are not merely hypothetical. Six states in addition to New Jersey have already disallowed deductions for the windfall profit tax. With the exception of a negligible amount of oil production in New York, none of

[8] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

[9] Aside from New York, only two states impose stock transfer taxes. J. Hellerstein, *State Taxation* 20-21 (1983). For New York, stock transfer taxes have "long been a source of substantial revenue." *Id.* at 145. The New York stock transfer tax, N.Y. Tax Law § 270 (McKinney 1986), is imposed, *inter alia*, on all sales of securities occurring within New York State, which necessarily includes all sales on the New York Stock Exchange. *Cf. Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977).

those states produce any crude oil. *See* authorities cited in Jurisdictional Statement filed by Amerada Hess Corporation appellants at 14-15.

In sum, the issue of constitutional limitations on state power to define taxable income warrants plenary review. A definitive resolution of the question whether it is permissible for a state to define income in a geographically tailored manner is essential in order to avoid the chaos described above.

II. New Jersey's Definition of Net Income Subject to Apportionment Violates the Due Process, Commerce and Equal Protection Clauses.

A. *Through Its Definition of Net Income, New Jersey Has Attributed to Itself a Disproportionate Share of the Taxpayers' Net Income in Violation of the Due Process Clause.*

A state may not, consistent with the Due Process Clause, tax value earned outside its borders. *Container Corp. of America* v. *Franchise Tax Board*, 463 U.S. 159, 164 (1983). The constitutionality of the unitary business/formula apportionment method is based on the premise that it results in each state taxing only that portion of net income which is reasonably attributable to the business conducted in that state. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 506 (1942). That premise is violated by the New Jersey approach.

By defining net income subject to apportionment such that deductions arising from exclusively out-of-state activity are disallowed, while ordinary business deductions arising from in-state activity are allowed, New Jersey has effectively attributed to itself a disproportionate share of the multistate taxpayers' income. A state can no more be free to discriminate

in its definition of net income subject to apportionment than it is to use a biased apportionment formula: since the net income figure is multiplied by the apportionment formula, both calculations must be subject to the same constitutional restraints. Otherwise, the state could simply accomplish through its definition of net income what it is barred from effecting through its apportionment formula.

What New Jersey is arguing for here is not, as it asserts, the right to apportion 100% of a unitary business's net income. That right is not being challenged. To the contrary, New Jersey is seeking the unfettered right to define net income in any way it sees fit — regardless of whether its definition taxes extraterritorial values or discriminates against out-of-state activity.

The New Jersey approach cannot be saved by its facial neutrality. Simply because New Jersey purports to disallow deductions for "all" federal income or profits taxes does not mean that it can shield the actual effect of its law from judicial scrutiny. This Court has rejected "formalism[s] [which] 'merely obscure the question whether the tax produces a forbidden effect.'" *American Trucking, supra* at 2846, *quoting Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 288 (1977). *See also Maryland* v. *Louisiana*, 451 U.S. 725, 756 (1981) ("A state tax must be assessed in light of its actual effect"). In *American Trucking*, Pennsylvania sought to uphold its flat taxes on trucks on the grounds that all vehicles, both in-state and interstate, paid the same flat tax. This Court had little difficulty rejecting that contention, noting that, "in practical effect," the tax imposed a greater cost per mile on interstate than on local carriers. *Id.* at 2841. Here, the practical effect of New Jersey's interpretation of its CBT is clear and undisputed regardless of its appearance of neutrality: there is no oil production in New Jersey and hence New Jersey's interpretation of "entire net income" imposes additional taxes on exclusively out-of-state activities, thus appropriating to New Jersey values which are beyond its constitutional authority to tax.

B. *New Jersey's Discriminatory Taxation Threatens the "Free Trade Zone" Created by the Commerce Clause.*

The central purpose of the Commerce Clause was "to create an area of free trade among the several States," *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 328 (1977). Within the "national free trade area," state boundaries are to be "economically irrelevant." *American Trucking, supra* at 2840-41. New Jersey's method of discriminatory taxation threatens the existence of the national free trade zone.

New Jersey's approach to enhancing state revenues at the sole expense of out-of-state activity can — and inevitably will — be viewed as a model by other states. Allowing each state to disfavor activities which are necessarily or predominantly performed elsewhere threatens the federal system. For example, states without natural resources may disallow severance taxes, and the resource-rich states may retaliate by disallowing the business expenses of high technology industry. This type of retaliation could continue *ad infinitum* until the national free trade zone has become a balkanized confederacy of retaliatory tax regions. The Commerce Clause does not allow the states to exercise such powers: "[T]axing or regulatory structures threatening to balkanize the national economy should be imposed, if at all, only by Congress, and not by an entity with less than a nationwide constituency." L. Tribe, *American Constitutional Law* 361 (1978).

Thus, it is no answer for the Supreme Court of New Jersey to assert that this law does not offend the Commerce Clause because, whatever the discriminatory effect on out-of-state industry, there are no local crude oil producers to be favored.[10]

[10] The Court below stated: "Denial of the W.P.T. deduction does not violate the commerce clause because it does not favor in-state over out-of-state economic activity." Appendix A to Jurisdictional Statement of Amerada Hess Corporation appellants at 34a.

This argument presupposes that the Commerce Clause was meant to be no more than an equal rights act as between local and interstate industries. When one recognizes the actual purpose of the Commerce Clause — the creation of a national free trade zone — the absence of affected local producers is properly seen as irrelevant. Indeed, under New Jersey's restrictive reading of the Constitution, its state tax code could explicitly deny deductions for all business expenses incurred in specifically-designated sister states.

More importantly, the New Jersey system, by focusing its taxation burdens on out-of-state activity, implicates the fundamental principle that there shall be no taxation without representation:

> Despite mechanical or artificial distinctions sometimes taken between the taxes deemed permissible and those condemned, . . . [l]ying back of these decisions is the recognized danger that, to the extent that the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state.

McGoldrick v. *Berwind-White Coal Mining Co.*, 309 U.S. 33, 45-46 n.2 (1940). The absence of favored local interests is simply not pertinent to the suspect nature of state regulation which "imposes special or distinct burdens on out-of-state interests unrepresented in the state's political process." *American Constitutional Law*, *supra* at 326.

C. *New Jersey's Parochial Discrimination Against Out-of-State Interests Violates the Equal Protection Clause.*

The Equal Protection Clause "forbids a State to discriminate in favor of its own residents solely by burdening 'the residents of other state members of our federation.' " *Metropolitan Life Ins. Co.* v. *Ward*, 470 U.S. 869, 878 (1985), *quoting Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 533 (1959). In *Metropolitan Life*, this Court held that the provisions of Alabama's tax code which imposed a higher rate of tax on foreign than on domestic insurance companies violated the Equal Protection Clause on the grounds that "Alabama's purpose . . . constitutes the very sort of parochial discrimination that the Equal Protection Clause was intended to prevent." *Id.* at 878.

The New Jersey law at issue here exemplifies the same type of "parochial discrimination" as that struck down in *Metropolitan Life*. New Jersey is favoring its own residents by imposing burdens on out-of-state activity which will not be shouldered by local taxpayers. Because New Jersey refuses to allow the deduction of indisputably legitimate business expenses which arise only out-of-state, the plain result of the taxation scheme is that certain multistate businesses are subjected to higher rates of taxation than New Jersey businesses.

"[A] state may not constitutionally favor its own residents by taxing foreign corporations at a higher rate." *Id. See also WHYY, Inc.* v. *Glassboro*, 393 U.S. 117, 120 (1968) (provision of New Jersey's property tax struck down as violative of the Equal Protection Clause because "New Jersey has denied the appellant a tax exemption which it accords other nonprofit corporations solely because of the appellant's foreign incorporation"); *Williams* v. *Vermont*, 472 U.S. 14 (1985) (Vermont provision allowing only residents to be credited for certain sales taxes gives rise to claim under Equal Protection Clause);

Gilbert Associates, Inc. v. *Commonwealth*, 498 Pa. 514, 447 A.2d 944 (1982) (Pennsylvania law which allowed domestic corporations to select apportionment formula, while prescribing particular apportionment formula for foreign corporations, held to violate both federal and state constitutions).

Refusing to allow a deduction has precisely the same impact as raising the rate of taxation. New Jersey's attempt to favor its constituents by imposing higher tax burdens on out-of-state interests should be struck down under the Equal Protection Clause.

Conclusion

Probable jurisdiction should be noted.

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Nos. 87-453 and 87-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

AMERADA HESS CORPORATION *et al.*,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeal from the Supreme Court of New Jersey

BRIEF OF THE AMERICAN MINING CONGRESS AND THE NATURAL GAS SUPPLY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF JURISDICTIONAL STATEMENTS OF APPELLANTS

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QUESTION PRESENTED

Whether the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution permit a State, in defining the apportionable business income of a multi-state unitary business, to include income contributed by an exclusively out-of-state business activity but to exclude associated costs incurred solely on account of that activity.

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Appellee.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF OF THE AMERICAN MINING CONGRESS AND THE NATURAL GAS SUPPLY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF JURISDICTIONAL STATEMENTS OF APPELLANTS

INTRODUCTORY STATEMENT

This brief is submitted by the American Mining Congress and the Natural Gas Supply Association as *amici curiae* in support of the jurisdictional statements filed by appellants in the above-captioned cases. Written consents of the appellants and the appellee have been obtained and filed with the Clerk of the Court.

INTEREST OF AMICI CURIAE

The American Mining Congress is a nonprofit association of approximately 450 companies that produce a major portion of the Nation's minerals, including coal, metals, and nonmetallic industrial and agricultural minerals. The Natural Gas Supply Association is a nonprofit association of approximately 75 companies that produce and market nearly 90% of the Nation's natural gas. Some of the appellants in this case or their subsidiaries are members of the *amici*.

This case is important to the members of these associations because of the potential impact that the decision of the New Jersey Supreme Court may have on the state tax treatment of expenses similar to the Federal Windfall Profit Tax ("WPT"), particularly

state severance taxes. The *amici* are concerned that, in computing apportionable business income for formulary apportionment purposes, other States will use this case as a road map to obtain larger tax revenues by disallowing deductions for expenses that are incurred only in connection with out-of-state income-producing activities.

SUMMARY OF ARGUMENT

The decision of the New Jersey Supreme Court to disallow a deduction for the WPT in computing the appellants' New Jersey taxable income has potential ramifications extending far beyond this case. The WPT is similar to state severance taxes and other localized production costs that relate to specifically identifiable production operations with an unambiguous geographical situs. Unless the decision below is reversed, the *amici* are concerned that States in which there is little or no mineral production may attempt to follow the New Jersey approach by disallowing deductions for severance taxes or other mineral production costs incurred outside those States. The amounts potentially involved are substantial.

The underlying issue in this case is to determine the portion of appellants' unitary business income that is attributable to their refining and marketing activities in New Jersey. That is all New Jersey may constitutionally tax. However, New Jersey seeks to tax more. New Jersey seeks to increase the amount of appellants' income apportioned to New Jersey under the standard three-factor apportionment formula by artificially increasing the amount of apportionable business income derived from out-of-state activities. This is accomplished by disallowing a deduction for

an expense that occurs solely outside of New Jersey—the WPT. In substance, the State is including in the appellants' apportionable business income the *gross* revenues derived from the out-of-state activities (oil production with no WPT deduction) and the *net* income derived from New Jersey activities (refining and marketing with deductions for all associated expenses). Such a hybrid definition of apportionable business income necessarily means that New Jersey's share of the appellants' true total net income is increased under the apportionment formula used by New Jersey. This result is inherently arbitrary and a violation of the Due Process Clause of the Constitution. Moreover, by denying out-of-state producers a deduction for certain costs that are effectively deductible by competitors who purchase rather than produce their crude oil or refined products, New Jersey also violates the Commerce and Equal Protection Clauses.

ARGUMENT

I. THIS CASE WARRANTS PLENARY REVIEW

A. Introduction

The New Jersey Supreme Court's opinion in this case has potential ramifications extending far beyond the specific issue decided by that court. As discussed in Part IB, the WPT involved in this case is similar to state severance taxes and other geographically localized mineral production costs. *Amici* are concerned that if the decision below is permitted to stand, States in which there is little or no mineral production ("non-producing States") may unconstitutionally seek to exploit the decision, in order to increase their income tax revenues, by following the New Jersey approach

and disallowing deductions for severance taxes and other mineral production costs incurred by unitary business taxpayers outside those States. Accordingly, the question presented in this appeal is of great importance to the minerals industry.

The amounts potentially at stake are substantial. In 1984, for example, United States mining and oil and gas companies, most of whom are represented by the *amici*, collectively paid over $7,000,000,000 in state severance taxes. Because deposits of hydrocarbons and hard minerals are concentrated in a limited number of States, approximately 80% of the foregoing 1984 severance tax payments went to only six States.[1] On the other hand, there are at least 30 States that impose no significant severance taxes.[2] These States would have nothing to lose, and everything to gain, if they could succeed in artificially increasing the amount of taxpayers' apportionable business income by adding back to true net income severance taxes and other production costs that are necessarily incurred outside the taxing States.

B. Since Severance Taxes and Other Mineral Production Costs Are Similar to the WPT, Non-Producing States May Attempt To Follow the New Jersey Approach by Disallowing Deductions for Those Costs

As a matter of *statutory* construction, the New Jersey Supreme Court had to conclude that the WPT

[1] In 1984, the States collected $7,248,943,000 in severance taxes. Of that amount, Alaska, Texas, Oklahoma, Louisiana, New Mexico and Wyoming collected approximately 80%. *Facts and Figures on Government Finance* e24-e25 (Tax Foundation, Inc. 23rd ed. 1986).

[2] As of 1984, 18 States (including New Jersey) had no severance tax revenues, and 12 other States had severance tax revenues of less than $10,000,000. *Ibid.*

was a tax "on or measured by profits or income" in order to add it back to the appellants' reported net income under the existing New Jersey statute. But there is nothing in the opinion of the court below suggesting that add-backs of this type are *constitutionally* limited to taxes "measured by profits or income." Accordingly, non-producing States may attempt to follow the New Jersey approach by disallowing deductions for severance taxes or other mineral production costs incurred outside the non-producing States.

Severance taxes, however computed, are a necessary cost of engaging in the businesses of producing oil and gas and mining hard minerals. In some jurisdictions, such taxes are based on the volume of production; in others, severance taxes are calculated with reference to the value of the production at the wellhead or mine.[3] But in all instances, the event giving rise to the tax liability is the extraction or severance of the hydrocarbons or minerals from the ground. Thus, severance taxes by their very nature relate to specifically identifiable operations that have an unambiguous geographical situs. In addition, severance taxes are imposed on each unit of production and do not relate to the overall profitability of the producer.

The WPT involved in this case is similar to state severance taxes. First, the WPT is imposed solely and exclusively in connection with oil *production* activities. As the court below noted, the WPT (J.S. App. 5a)—

> was imposed on production at the wellhead rather than on these integrated domestic producers'

[3] See, *e.g.*, New Mexico Stat. Ann. §7-29-4 (1978); Tex. Code Ann. §§201.051, 201.052, 201.054 (1982).

> overall net profits or income ultimately calculated from gross sales and net profits as measured at the pump.

Mechanically, this is accomplished by imposing the WPT as each barrel of crude oil is "removed" from the producing premises by being brought to the surface and physically transported away from the immediate vicinity of the well. IRC, §4986(a); Treas. Regs. §51.4996-1(d)(1). Thus, the WPT clearly applies to production activities at a specific, identifiable location.

In addition to being triggered by the production of oil, the amount of the WPT is determined by the increase in value of the oil at the wellhead due to Federal price decontrol. IRC, §§4986(a), 4988(c), and 4989. Accordingly, the amount of "windfall profit" subject to the WPT involved in this case was determined on a barrel by barrel basis, solely by reference to activities in the production States—not in New Jersey. The court below acknowledged the limited geographical basis for determining the amount subject to tax, noting (J.S. App. 6a)—

> the basic measure of the windfall profit was the difference between the uncontrolled and controlled price *of a barrel of crude oil at the point the oil was removed from the producing property*. (Emphasis supplied.)

To be sure, the taxable "windfall profit" for each barrel of crude oil is subject to a net income limitation equal to "90 percent of the net income attributable to such barrel." IRC, §4988(b)(1). But even this lim-

itation is determined on a geographically limited basis.[4]

Finally, notwithstanding the per barrel net income limitation, the WPT is clearly not an income tax in the conventional sense. It is payable on the extraction of each profitable barrel even if the taxpayer's overall production operations (taking into account all barrels from all of its production properties) are unprofitable and even if the taxpayer's entire unitary business (including non-production activities) is unprofitable. The WPT is just as much a cost of production as the cost of operating the producing oil rig.

A non-producing State may seek to rely on these similarities between the WPT and state severance taxes as a justification for extending the rationale of the New Jersey Supreme Court to state severance taxes. In addition, such an approach might be taken by the non-producing States with respect to other geographically specific production costs. This case merits review by this Court because the numerous non-producing States should not be led to believe that they may constitutionally increase their revenues by disregarding billions of dollars of severance taxes (see n.1, *supra*) and other production costs that are necessarily incurred elsewhere. As we shall now show, any such action would be plainly unconstitutional.

[4] The "net income attributable to a barrel" is determined by dividing "the taxable income *from the property* for the taxable year attributable to taxable crude oil" by "the number of barrels of taxable crude oil *from the property*." IRC, §4988(b)(2). (Emphasis supplied.)

II. DISALLOWING DEDUCTIONS FOR EXPENSES, SUCH AS THE WPT, THAT ARE ATTRIBUTABLE SOLELY TO AN OUT-OF-STATE ACTIVITY VIOLATES THE DUE PROCESS, COMMERCE, AND EQUAL PROTECTION CLAUSES

A. Due Process Clause

Under the Due Process Clause, a State may tax a corporation only on that portion of the corporation's income that is attributable to the corporation's activities in the taxing State. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). The State may not tax "extraterritorial values" (*Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942)) or "tax value earned outside its borders" (*ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982)).

In this case, as the New Jersey Supreme Court noted (J.S. App. 2a), appellants are vertically integrated oil companies engaged in all phases of the oil business, including exploration, production, refining, manufacturing, and marketing. All of appellants' production activities occur outside New Jersey. Their only New Jersey activities are limited to refining and marketing.

The issue, therefore, is to determine the portion of appellants' unitary business income that is attributable to their refining and marketing activities in New Jersey. That is all New Jersey may constitutionally tax. In fact, however, New Jersey seeks to tax more.

This can be demonstrated in several different ways. First, and most significantly, New Jersey's add back of the WPT, an expense incurred solely in connection with an out-of-state activity (production), is inconsistent with the entire theory of formulary appor-

tionment. Under formulary apportionment, the total income of the unitary business is ratably divided (on the basis of the apportionment factors employed) between the taxing State and all other jurisdictions in which the unitary business is conducted, so that the taxing State receives the same "rate of return"[5] as is earned by the entire business collectively.[6] See *Container*, 463 U.S. at 183, n.20. Thus, where, as here, the traditional three-factor apportionment formula is employed, the taxing State will receive the same amount of income for every dollar of payroll, property, and sales in the State as the entire unitary business earns, on the average, for every dollar of payroll, property, and sales in all locations.

To achieve this result, the apportionable business income of the unitary business must be consistently calculated for all phases of the business in order to reflect the contributions made in all locations. Provided this is done, formulary apportionment will produce a constitutionally acceptable result because the apportionment factors will fairly measure "the relative contribution of the activities in the [taxing State] to the production of the total unitary income." *Butler Bros.*, 315 U.S. at 509, quoting from the California Supreme Court opinion in that case.

By comparison, if the expenses of the in-state activities of an integrated unitary business are deducted in full in determining apportionable business income whereas certain expenses of out-of-state activities of the unitary business are not deducted, formulary apportionment cannot work. Under such circumstances, the apportionment factors will produce a different "rate of return" for the out-of-state activities than for the in-state activities, because the different constituent activities of the business were accounted for differently. By disallowing a deduction for certain expenses incurred solely in connection with out-of-state activities, the State is artificially inflating the amount of business income derived from those activities. Specifically, the State is including in apportionable business income the *gross* revenues *before* expenses from certain out-of-state activities (oil production in this case) and *net* income *after* expenses from the in-state activities (refining and marketing in this case). Using such a hybrid definition of apportionable income *necessarily* means that a taxpayer's "rate of return" on out-of-state activities will be greater than its "rate of return" on in-state activities. Such a result is "inherently arbitrary," and therefore a clear violation of the Due Process Clause. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

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[5] The term "rate of return" is being used herein as a shorthand way of describing the ratio of income to the payroll, property, and sales producing that income.

[6] This can be demonstrated mathematically. The basic apportionment formula, using a single payroll, property, and sales ("PPS") factor for simplicity, is:

$$\text{unitary income} \times \frac{\text{state PPS}}{\text{total PPS}} = \text{state income}$$

Mathematically, this is equivalent to:

$$\frac{\text{state PPS}}{\text{total PPS}} = \frac{\text{state income}}{\text{unitary income}}$$

The "rate of return" everywhere will be the same because the foregoing equation can be rewritten:

$$\frac{\text{state income}}{\text{state PPS}} = \frac{\text{unitary income}}{\text{total PPS}}$$

The foregoing discussion would unquestionably apply if New Jersey were simply to disallow all non-New Jersey salary deductions, and we assume the State would not defend such a system. Obviously, pre-salary income from operations outside New Jersey should not be apportioned along with post-salary income from operations in New Jersey. But disallowing WPT is conceptually no different. The effect is to overstate the contribution of appellants' out-of-state production activities to the unitary business income of their integrated oil businesses. Furthermore, in view of the large amounts of WPT paid by appellants, the impact on their New Jersey tax liabilities is far in excess of any distortion that may be constitutionally tolerable. *Cf.*, *Container*, 463 U.S. at 182-184.

Adding back WPT is conceptually far different from adding back Federal income taxes. Thus, it is no answer that the New Jersey Supreme Court held, for statutory purposes, that the WPT is a tax "paid or accrued to the United States on or measured by profits or income." Adding back Federal income taxes is perfectly consistent with the theory of formulary apportionment, which--

> owes its existence to the fact that with respect to a business earning income through a series of transactions beginning with manufacturing in one State and ending with a sale in another, a precise—or even wholly logical—determination of the State in which any specific portion of the income was earned is impossible. [*Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 286 (1978) (Powell, J., dissenting)]

Since the Federal income tax is imposed on the entire net income of the unitary business, it burdens all

activities of the business equally. Thus, adding back Federal income taxes (or comparable state income taxes) does not disturb the relative apportionment of income to the different locations in which the unitary business is conducted. By comparison, as discussed above, the WPT is imposed only on production activities, without regard to the profitability of the unitary business as a whole. Thus, by adding back the WPT, New Jersey is effectively taxing a portion of the WPT plus the income fairly attributable to appellants' New Jersey activities.

The same point also is easily made by recalling that the imposition of WPT accompanied the phasing out of crude oil price controls. Thus, in effect, the Federal government took back a large portion of the "additional revenue resulting from decontrol." *United States v. Ptasynski*, 462 U.S. 74, 76 (1983). The combined effect of both decontrol plus the WPT was only a partial increase in producers' revenues. Yet, New Jersey treats the *full* amount of the WPT as increasing appellants' unitary income and thereby increasing the amount of that income attributed to appellants' New Jersey refining and marketing activities. This additional attribution is so clearly contrary to the actual facts that it constitutes a *per se* violation of the Due Process Clause.

B. Commerce and Equal Protection Clauses

As a general proposition, the States have considerable leeway in determining what deductions will be allowable in computing the apportionable taxable income of a unitary business. But no State should be permitted to adopt a facially neutral rule that necessarily discriminates against a major class of taxpayers in actual practice. *American Trucking*

Associations, Inc. v. Scheiner, 107 S. Ct. 2829 (1987); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984).

The key fact in this case is that New Jersey produces no oil. Accordingly, New Jersey's facially neutral rule disallowing a deduction for certain oil production taxes necessarily discriminates against out-of-state producers who sell their end products in New Jersey, without adversely affecting any New Jersey based retailers who purchase similar products elsewhere for resale in New Jersey. In computing their apportionable business income that is subject to New Jersey tax, the out-of-state producers are allowed no deduction for the WPT. By contrast, local distributors who purchase the refined products for resale in New Jersey are allowed a full deduction for their cost of goods sold. As an economic matter, a distributor's cost of goods sold will always include the wellhead value of the crude oil, because that amount will be included in the price charged by the crude oil producer and passed on to every subsequent purchaser including the consumer. Since the WPT is based on the wellhead value of the oil and is payable out of the producer's wellhead selling price, the independent distributor's allowable cost of goods sold deduction necessarily subsumes the dollar amount of the WPT expense that New Jersey disallows as a deduction to the producer.

Thus, the out-of-state producer who sells refined products in New Jersey is denied a deduction that is effectively available to anyone else selling the same products in New Jersey. The effect of disallowing the deduction is, of course, to increase the out-of-state producer's total unitary business income, and, therefore, the amount of income that is apportioned to New Jersey under its standard three-factor apportionment formula. The resulting increase in New Jersey's tax revenues *cannot* be a fair reflection of the out-of-state producer's activities in New Jersey, because that increase is attributable *directly* and *solely* to production activities outside the State.

CONCLUSION

Probable jurisdiction should be noted.

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Nos. 87-453 and 87-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

AMERADA HESS CORPORATION, *et al.*,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,

v.

DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

On Appeals from the Supreme Court of New Jersey

BRIEF OF THE AMERICAN MINING CONGRESS AND THE NATURAL GAS SUPPLY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF APPELLANTS

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QUESTION PRESENTED

Whether the Due Process, Commerce, and Equal Protection Clauses of the United States Constitution permit a State, in defining the apportionable income of a multistate unitary business, to include income contributed by an exclusively out-of-state business activity but to exclude associated costs incurred solely on account of that activity.

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No. 87-453

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Texaco Inc. and Tenneco Oil Company,
Appellants,

v.

Director, Division of Taxation,
New Jersey Department of the Treasury,
Appellee.

ON APPEALS FROM THE SUPREME COURT OF NEW JERSEY

BRIEF OF THE AMERICAN MINING CONGRESS AND THE NATURAL GAS SUPPLY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF APPELLANTS

INTRODUCTORY STATEMENT

This brief is submitted by the American Mining Congress and the Natural Gas Supply Association as *amici curiae* in support of the appellants in the above-captioned cases. Written consents of the appellants and the appellee have been obtained and filed with the Clerk of the Court.

INTEREST OF AMICI CURIAE

The American Mining Congress is a nonprofit association of approximately 450 companies that produce a major portion of the Nation's minerals, including coal, metals, and nonmetallic industrial and agricultural minerals. The Natural Gas Supply Association is a nonprofit association of approximately 75 companies that produce and market nearly 90% of the Nation's natural gas. Some of the appellants in this case or their subsidiaries are members of the *amici*.

This case is important to the members of these associations because of the potential impact that the decision of the New Jersey Supreme Court may have on the state tax treatment of costs similar to the Federal Windfall Profit Tax ("WPT"), particularly state severance taxes. In 1984, for example, United States mining and oil and gas companies, most of whom are represented by the *amici*, collectively paid over $7,000,000,000 in state severance taxes. Because deposits of hydrocarbons and hard minerals are concentrated in a limited number of States, approximately 80% of the foregoing 1984 severance tax payments were paid to only six States.[1] On the other hand, there are at least 30 States that impose no significant severance taxes.[2] The *amici* are concerned that, if the decision below is affirmed, other States will similarly seek larger tax revenues by disallowing deductions, in computing apportionable income for formulary apportionment purposes, for costs that are incurred solely in connection with out-of-state production activities.

SUMMARY OF ARGUMENT

The underlying issue in this case is to determine the portion of appellants' unitary business income that is attributable to their marketing, refining, and other non-production oil activities in New Jersey. That is all New Jersey may constitutionally tax.

New Jersey purports to use the traditional three-factor formulary apportionment method for this purpose. In fact, New Jersey's approach to determining appellants' apportionable income is inconsistent with the underlying rationale and justification for formulary apportionment. New Jersey seeks to increase the amount of appellants' income apportioned to New Jersey under the apportionment formula by artificially increasing the amount of apportionable income de-

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[1] In 1984, the States collected $7,248,943,000 in severance taxes. Of that amount, Alaska, Texas, Oklahoma, Louisiana, New Mexico and Wyoming collected approximately 80%. *Facts and Figures on Government Finance* e24-e25 (Tax Foundation, Inc. 23rd ed. 1986).

[2] As of 1984, 18 States (including New Jersey) had no severance tax revenues, and 12 other States had severance tax revenues of less than $10,000,000. *Ibid.*

rived from their out-of-state production activities. This is accomplished by disallowing a deduction for a production cost—the WPT—that is incurred solely on account of those out-of-state activities.

In substance, the State is including in the appellants' apportionable income the *gross* revenue derived from the out-of-state production activities without deductions for all associated costs (oil production income with no WPT deduction) and the *net* income derived from New Jersey activities (refining, marketing, and other non-production oil activities with deductions for all associated costs). Such a hybrid definition of apportionable income necessarily means that New Jersey is taxing extraterritorial values in violation of the Due Process and Commerce Clauses of the Constitution.

Moreover, by denying out-of-state producers a deduction for certain costs that are effectively deductible by competitors who purchase rather than produce their crude oil or refined products, New Jersey also impermissibly burdens interstate commerce in violation of the Commerce and Equal Protection Clauses of the Constitution.

ARGUMENT

I. NEW JERSEY'S INCLUSION OF INCOME FROM APPELLANTS' OUT-OF-STATE PRODUCTION ACTIVITIES IN THE APPORTIONABLE INCOME OF THEIR UNITARY OIL BUSINESSES WITHOUT ALLOWING A DEDUCTION FOR WPT, A COST INCURRED SOLELY ON ACCOUNT OF THOSE PRODUCTION ACTIVITIES, VIOLATES THE DUE PROCESS AND COMMERCE CLAUSES.

A. The Rationale for Formulary Apportionment.

Under both the Due Process and the Commerce Clauses, a State may tax a corporation only on that portion of the corporation's income that is attributable to the corporation's activities in the taxing State. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). The State may not tax "extraterritorial values" (*Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942)) or "tax value earned outside its borders" (*ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982)).

In this case, as the New Jersey Supreme Court noted (J.S. App. 2a),[3] appellants are vertically integrated oil companies engaged in all phases of the oil business, including exploration, production, refining, manufacturing, and marketing. Appellants engage in business both within and without New Jersey. All of appellants' production activities occur outside New Jersey. Their only New Jersey activities are limited to refining, marketing, and other non-production oil activities.

[3] "J.S. App." refers to the Appendix filed by appellants with the Jurisdictional Statement in No. 87-453.

The issue, therefore, is to determine the portion of appellants' income that is attributable to their refining, marketing, and other non-production activities in New Jersey. That is all New Jersey may constitutionally tax.

Where, as here, a taxpayer is engaged in a multistate unitary business, this Court has recognized the difficulty of determining the portion of the taxpayer's income that is attributable to just its activities in the taxing State. In such circumstances, the State is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920). Similarly, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 (1980), this Court stated:

> . . . separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required. (Citation omitted).

Thus, as this Court noted in *Container Corp. v. Franchise Tax Bd.*, *supra*, it is the theoretical weaknesses of "formal geographical accounting" that "justify resort to formula apportionment." *Container*, *supra*, at 181. Accordingly, for that reason, this Court has upheld the use of formulary apportionment on many occasions. See, e.g., *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980); *Mobil*, *supra*; *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Butler Bros. v. McColgan*, *supra*; *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924); and *Underwood Typewriter Co. v. Chamberlain*, *supra*.

B. In Contrast to Separate Geographical Accounting, Formulary Apportionment Assumes an Equal Rate of Return in All Jurisdictions in Which the Unitary Business Is Conducted.

Under formulary apportionment, the income to be attributed to the taxpayer's activities in the taxing State is determined by apportioning the income of the entire unitary business. The income is ratably divided (on the basis of the apportionment factors employed) between the taxing State and all other jurisdictions in which the unitary business is conducted, so that the taxing State receives the same "rate of return"[4] (on the taxpayer's in-state factors) as is earned by the entire unitary business collectively (on the taxpayer's total factors located everywhere the

[4] The term "rate of return" is used herein as a shorthand way of describing the ratio of income to the apportionment factors employed in producing that income. That term also was used by this Court in *Container*, *supra*, at 183, n. 20. In this case, New Jersey, like most States, uses three, equally weighted apportionment factors—payroll, property, and sales. Thus, in this case, "rate of return" means the ratio of income earned to the payroll, property, and sales producing that income.

unitary business is conducted).[5] Where, as here, the traditional, three-factor apportionment formula is employed, the taxing State will be apportioned a ratable share of the unitary business income based on the average of three ratios (payroll in the taxing State to payroll everywhere, property in the taxing State to property everywhere, and sales in the taxing State to sales everywhere).

In *Container*, such ratable apportionment of the taxpayer's unitary business income, although recognized to be "imperfect", was sustained because of this Court's willingness to accept in that case "the very rough economic assumption that rates of return on property and payroll—as such rates of return would be measured by an ideal accounting method that took all transfers of value into account—are roughly the same in different taxing jurisdictions". *Container*, *supra*, at 183, n. 20.

[5] This can be demonstrated mathematically. The basic apportionment formula, using a single payroll, property, and sales ("PPS") factor for simplicity, is:

$$\text{unitary income} \times \frac{\text{state PPS}}{\text{total PPS}} = \text{state income}$$

Mathematically, this is equivalent to:

$$\frac{\text{state PPS}}{\text{total PPS}} = \frac{\text{state income}}{\text{unitary income}}$$

The "rate of return" everywhere will be the same because the foregoing equation can be rewritten:

$$\frac{\text{state income}}{\text{state PPS}} = \frac{\text{unitary income}}{\text{total PPS}}$$

C. Ratable Apportionment Under Formulary Apportionment Results in Extraterritorial Taxation Where the Apportionable Income Base Is Geographically Distorted by Disallowing Out-of-State Costs.

Since formulary apportionment treats each jurisdiction in which the unitary business is conducted as having the same rate of return, formulary apportionment is permissible only where such treatment is warranted. This means that the apportionable income of the business must be determined in a manner that is conceptually consistent with its ratable apportionment to the taxing State. Each of the constituent activities of the unitary business (e.g., exploration, production, refining, etc. in the case of an oil company) must be treated in a consistent manner. Only if this is done will formulary apportionment produce a constitutionally acceptable result, because only then will the apportionment factors fairly measure "the relative contribution of the activities in the [taxing State] to the production of the total unitary income." *Butler Bros.*, *supra* at 509, quoting from the California Supreme Court opinion in that case.

By comparison, if the constituent activities of the unitary business are treated in an inconsistent manner, as occurs when the costs associated with the in-state activities of the unitary business are deducted in full in determining apportionable income while, at the same time, certain costs of out-of-state activities are not deducted, formulary apportionment cannot work properly. Under such circumstances, it is no longer appropriate to assume that such inconsistently determined income is ratably earned in all jurisdictions, and utilization of a formula that assumes a ratable return is no longer justified. By disallowing a deduction for certain costs incurred solely on ac-

count of out-of-state activities, the State is artificially inflating the amount of income derived from those activities. Using such a hybrid definition of apportionable income *necessarily* means that a taxpayer's "rate of return" cannot be the same in all jurisdictions, although formulary apportionment is permissible only when it may fairly be assumed that the rate of return in all jurisdictions is the same. Ratable apportionment is "inherently arbitrary" when the apportionable income base has been determined in a geographically inconsistent manner. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920). The inevitable result is extraterritorial taxation in violation of the Due Process and Commerce Clauses.

The economic assumption that rates of return are roughly the same in different taxing jurisdictions cannot be made in this case in view of New Jersey's treatment of appellants' out-of-state production activities. In substance, New Jersey is including in apportionable income the *gross* revenue from the out-of-state activities without deductions for all associated costs (oil production income with no WPT) and *net* income from the in-state activities (refining, marketing, and other non-production oil activities with deductions for all associated costs). As New Jersey recognizes (Motion 14),[6] the WPT is a geographically localized cost associated solely with appellants' oil production. The rate of return from oil production when measured on this basis is obviously not comparable with the rate of return from refining, marketing, and other non-production oil activities when measured on

[6] "Motion" refers to the Motion to Dismiss or Affirm in No. 87-453.

the basis of net income. Inclusion of the income from the production activities in apportionable income without the allowance of an associated expense, the WPT, thereby makes ratable apportionment inappropriate.

As discussed above, this Court has upheld the constitutionality of formulary apportionment because of the difficulties inherent in separate geographical accounting. Accordingly, for that reason, each State in which a unitary business is conducted is treated as receiving the same rate of return and formulary apportionment is, of necessity, geographically neutral. Against this background, the disallowance of costs on a geographically inconsistent basis is inapporpriate and undermines the integrity of formulary apportionment.

New Jersey's reliance (Motion 14) on *Exxon Corp. v. Wisconsin, supra*, is misplaced. In *Exxon*, this Court merely held that an oil company's out-of-state production activities (which were part of its unitary business) could be taken into account by the taxing State for formulary apportionment purposes. *Amici* do not question that holding. But there is no support whatsoever in that case for treating the out-of-state production activities more onerously than other activities of the unitary business by disallowing costs associated only with those production activities.

Nor is there any merit to New Jersey's apparent suggestion (Motion 17-19) that the apportionable income base may be determined in any fashion whatsoever as long as it does not exceed gross receipts and as long as it is apportioned. New Jersey fails to acknowledge any requirement that the apportionable base, as ultimately determined, be suitable for ratable apportionment. Since the base in this case was geo-

graphically skewed, it is no longer reasonable to assume that it was ratably earned in all jurisdictions. Apportioning appellants' net income from refining, marketing, and other non-production oil activities (the only New Jersey activities) and appellants' pre-WPT income from oil production (non-New Jersey activities) will inevitably result in the taxation by New Jersey of out-of-state values (oil production net income). Contrary to New Jersey's assertion (Motion 14), appellants' burden is not to establish "that something other than income from their integrated petroleum enterprises is being taxed." Appellants need only show that New Jersey is taxing non-New Jersey income. This burden has been satisfied.

Nor is it an answer, as the New Jersey Supreme Court concluded for statutory purposes, that the WPT is a tax "paid or accrued to the United States on or measured by profits or income." Adding back Federal income taxes is perfectly consistent with the theory of formulary apportionment which, as discussed above—

> owes its existence to the fact that with respect to a business earning income through a series of transactions beginning with manufacturing in one State and ending with a sale in another, a precise—or even wholly logical—determination of the State in which any specific portion of the income was earned is impossible. [*Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 286 (1978) (Powell, J., dissenting)]

Since the Federal income tax is imposed on the entire net income of the unitary business, it burdens all activities of the business equally. Thus, adding back

Federal income taxes (or comparable state income taxes) does not disturb the relative apportionment of income to the different locations in which the unitary business is conducted. By comparison, the WPT is imposed only on production activities, without regard to the profitability of the unitary business as a whole. Thus, by adding back the WPT, New Jersey is effectively taxing a portion of the WPT plus the income fairly attributable to appellants' New Jersey activities.

The same point also is easily made by recalling that the imposition of WPT accompanied the phasing out of crude oil price controls. Thus, in effect, the Federal government took back a large portion of the "additional revenue resulting from decontrol." *United States v. Ptasynski*, 462 U.S. 74, 76 (1983). The combined effect of both decontrol and the WPT was only a partial increase in producers' revenues. Yet, New Jersey treats the *full* amount of the WPT as increasing appellants' unitary income and thereby increasing the amount of that income attributed to appellants' New Jersey activities.

II. DISALLOWANCE OF A DEDUCTION FOR THE WPT DISCRIMINATES AGAINST OIL PRODUCERS IN VIOLATION OF THE COMMERCE AND EQUAL PROTECTION CLAUSES.

The disallowance of a deduction for the WPT raises a number of discrimination issues arising under the Commerce and Equal Protection Clauses that are discussed by appellants. Producers of natural resources are particularly vulnerable to discriminatory tax burdens because their production activities are clearly identified with a specific geographic location, and yet the treatment of the costs associated with those activities may be carved out for unfavorable treatment under facially neutral statutes. The *amici*, as pro-

ducers of natural resources, are concerned that the decision of the New Jersey Supreme Court may lead other States to impose discriminatory tax burdens.

By disallowing a deduction for WPT, an oil production cost, New Jersey necessarily discriminates against oil producers who sell their products in New Jersey as contrasted with non-producers who sell similar products in New Jersey. Under the result below, producers are not allowed a deduction for the WPT in determining their apportionable income. By contrast, non-producers who sell their products in New Jersey are allowed a full deduction for their cost of goods sold. As an economic matter, a non-producer's cost of goods sold will always include the wellhead value of the crude oil, because that amount will be included in the price charged by the crude oil producer and passed on to every subsequent purchaser including the consumer. Since the WPT is based on the wellhead value of the oil and is payable out of the producer's wellhead selling price, the non-producer's allowable cost of goods sold deduction necessarily subsumes the dollar amount of the WPT cost that New Jersey disallows as a deduction to the producer. Thus, the producer who sells refined products in New Jersey is denied a deduction that is effectively available to any non-producer selling the same products in New Jersey.

New Jersey acknowledges that producers are discriminated against (Motion 22), but the State offers no justification for singling out this class of interstate taxpayers. The State simply relies (Motion 21-22) on *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), as authorizing such discrimination.

This case is far different from *Exxon*. In *Exxon* this Court upheld a Maryland statute that prohibited oil producers or refiners from operating retail service stations within Maryland, concluding (*Exxon, supra*, at 125) that the statute bore "a reasonable relation to the State's legitimate purpose in controlling the gasoline retail market." Here, by comparison, producers are permitted to compete with non-producers in the New Jersey refining and marketing of oil products, but only if the producers are willing to bear an economic burden (no deduction for WPT) not imposed on non-producers. New Jersey has made absolutely no attempt to justify this difference in tax treatment. The *amici* believe there is no Constitutional justification for disadvantaging in this manner oil producers engaged in interstate commerce.

CONCLUSION

The decision of the New Jersey Supreme Court should be reversed.

Respectfully Submitted,

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INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce, the National

Association of Manufacturers and the Chamber of Commerce of the United States of America as *amici curiae* in support of the appellants in the above-captioned cases. Written consents of the appellants and the appellee have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

The Council of State Chambers of Commerce ("COUNCIL"), organized in 1932, consists of 40 Chambers of Commerce. The Committee on State Taxation ("COST"), one of the three advisory committees of the COUNCIL, consists of 274 corporate members which conduct a substantial portion of the interstate commerce of United States taxpayers. One of COSTS's principal activities has been to work with the states and others toward developing fair and equitable standards of state taxation.

The National Association of Manufacturers of the United States of America ("NAM") is a non-profit, voluntary business association incorporated under the laws of the State of New York. The NAM represents more than 13,000 companies, large and small, located in every state. Further, NAM is affiliated with an additional 158,000 businesses through the Associations Council and the National Industrial Council. The membership of the NAM represents an estimated 80 percent of all goods manufactured in the United States.

The Chamber of Commerce of the United States ("CHAMBER") is the largest federation of business organizations and individuals in the United States. Current CHAMBER membership includes more than 180,000 corporations, partnerships and proprietorships, as well as several thousand trade associations and state and local chambers of commerce. The CHAMBER regularly advocates its members' views in court on

issues of national concern to the American business community.

Member companies of COST, NAM and the CHAMBER are representative of that part of the nation's business sector which is most directly affected by state taxation of interstate operations. These members include most of the appellants and other oil companies, as well as companies engaged in a diverse range of manufacturing, retailing and financial pursuits. COST, NAM and the CHAMBER are, therefore, vitally interested in cases such as this one which present issues significantly affecting state taxation of interstate commerce.

INTRODUCTION AND SUMMARY OF ARGUMENT

The American public continually puts its elected representatives in a no-win situation: everybody wants more public services but nobody wants to pay for them. The legislator who balks at expanding increasingly expensive public services is vilified as lacking in compassion. If the same legislator raises taxes to pay for those services, he or she is certain to encounter voter hostility at election time. Faced with these twin pressures, state representatives inevitably welcome methods of raising revenue that impose a disproportionate share of the tax burden on businesses and voters that are safely out-of-state.

Many of the most obvious routes to extraterritorial taxation have already been closed off by this Court. For example, New Hampshire's "commuter" income tax imposed exclusively on nonresidents was invalidated in *Austin* v. *New Hampshire*, 420 U.S. 656 (1975), and New York's allowance of personal exemptions for residents only was invalidated in *Travis* v. *Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920). In the corporate area, states have been precluded from assessing facially neutral, "flat" taxes that have the effect of imposing disproportionate burdens

on interstate corporations, *American Trucking Ass'ns* v. *Scheiner*, 107 S. Ct. 2829 (1987), and from selecting apportionment formulas that attribute an intrinsically disproportionate share of corporate income to the taxing state. *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 121 (1931).

The present case challenges New Jersey's novel method of exporting the state's tax burden: New Jersey disallows deductions for certain costs which are necessarily incurred out-of-state.

Superficially, the New Jersey taxation scheme has the appearance of a standard formula apportionment calculation. Under the New Jersey Corporation Business Tax Act (1945), N.J. Stat. Ann. §§ 54:10A-1 *et seq.* (West 1986) ("CBT"), a multistate corporation multiplies its net income — wherever earned — by a three-factor apportionment formula to yield the amount of the company's net income that is attributable to New Jersey. N.J. Stat. Ann. § 54:10A-6 (West 1986).[1]

The New Jersey taxation scheme diverges from the ordinary in its definition of "net" income. As to most taxpayers, the CBT taxes only net income, meaning that taxpayers deduct from gross receipts their costs and expenses, including, *inter*

[1] New Jersey's apportionment formula is the average of the following three fractions:

$\frac{\text{in-state receipts}}{\text{total company receipts}}$; $\frac{\text{in-state payroll}}{\text{total company payroll}}$; and $\frac{\text{in-state property}}{\text{total company property}}$.

This calculation yields a rough approximation of how much of a company's total operations and resources are in New Jersey. To take a simplified example of how the process works, if a unitary business's total net income from its operations throughout the country is $100, and, based on the apportionment formula, an average of one quarter of its receipts, payroll and property are found in New Jersey, then the company's New Jersey taxable income is $25. The New Jersey corporate tax rate of 9 percent is then applied to the $25 of New Jersey taxable income for a tax due to the state of $2.25. N.J. Stat. Ann. §§ 54:10A-5, 54:10A-6 (West 1986).

alia, the cost of severance taxes.[2] However, as to taxpayers who are required to pay the crude oil windfall profit tax of 1980, 26 U.S.C. §§ 4986 *et seq.* (the "WPT"), what New Jersey calls "net" income is not really net income at all, because those taxpayers are required to "add back" to their net incomes the cost of the WPT. N.J. Stat. Ann. § 54:10A-4(k)(2)(C) (West 1986).[3]

The immediate effect is readily apparent: the WPT is a federal excise tax triggered by the removal of crude oil from the vicinity of the well. I.R.C. § 4986(a); Treas. Reg. § 51.4996-1(d)(1). There are no oil wells in New Jersey. Indeed, the State has no proven reserves of crude oil at all.[4] Hence, New Jersey has managed to *add an element* to net income which *cannot* burden in-state activity. The burden of the add-back requirement must fall entirely on out-of-state activity, just as surely as would a requirement that oil and gas companies add back all expenses incurred in Texas and Louisiana.

The domestic attractiveness of such a taxation scheme is undeniable. Through the add-back requirement, New Jersey denies the deductibility of a very substantial cost which *cannot* be incurred in-state. In so doing, the State has admittedly raised approximately $88 million in revenue[5] without imposing

[2] Net income under the CBT is based on the federal definition of net income. N.J. Stat. Ann. § 54:10A-4(k) (West 1986). As such, the CBT allows the deduction of severance taxes, which are treated for federal tax purposes as deductible business expenses or costs of goods sold. *See* 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶32.2.3 at 32-17 to 32-18 (1981).

[3] On its face, the CBT requires the add back of all federal "profits or income" taxes. N.J. Stat. Ann. § 54:10A-4(k)(2)(C) (West 1986). In fact, the only so-called "profits or income" tax which is deductible for federal income tax purposes — and thus the only item which is added back under this provision — is the WPT.

[4] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

[5] Motion to Dismiss or Affirm, at 11 n.8. The $88 million figure is exclusive of interest on those funds over the preceding eight years.

a single dime of additional tax burden on in-state activity. Moreover, and in this the State must truly be given credit for creativity, the add-back requirement makes a virtue out of scarcity. The very fact that New Jersey has no crude oil is what makes the scheme work.[6]

The factors that make New Jersey's scheme locally attractive make it dangerous from the perspective of the nation. If all it takes to export a state's tax burden is to identify some resource that the state does *not* have, then most states can do that, and many more surely will. The specter of state governments being financed by increasingly unrepresentative taxes is a serious one: our constitutional system presumes that those taxed are represented in the taxing authority. To the extent that presumption is invalid, the legitimacy of the system breaks down.[7]

Of equal importance, New Jersey's taxation scheme is dangerous because it exploits the existing tensions between

[6] New Jersey has asserted that the challenged taxation scheme was not ill-motivated. This assertion is irrelevant. To be sure, the legislature had no intent with respect to the WPT when it enacted the add-back provision in 1958. On the other hand, it was not the legislature that construed this provision as applying to the WPT; it was a state administrative official, the Director of the Division of Taxation. Whether the Director's interpretation was motivated by his dispassionate reading of the statute or by a desire to raise revenue at the expense of interstate commerce is simply beside the point.

[7] The economic efficiency of the system also breaks down to the extent tax burdens are exported out-of-state. When the individuals and businesses that stand to benefit from the state's expenditure of funds are the same people who have to foot the bills, some rough equilibrium will be reached between what the state's residents want and what they are willing to pay for. The conflicting demands for more services and lower taxes are simply the working out in the political forum of the same forces of supply and demand more readily recognized in the private market. In economic terms, the correct or "efficient" level of both taxes and public services will be reached only if the residents of the state have to pay their own bills. If New Jersey can compel business activities in Louisiana to shoulder a disproportionate amount of New Jersey's tax burden, then New Jersey's level of spending will be higher and Louisiana's will necessarily be lower than if each state had to fund its proper amount of its own spending.

the states over the distribution of natural resources. The Framers were deeply concerned that the union could be torn apart by resentments and rivalries between the states. The prescience of their concerns has been borne out in this area as in so many others. The rivalries between the oil-exporting states and the oil-importing states are only one example. Through its tendency to exploit disparities in resources between the states, the New Jersey taxation scheme threatens to create a balkanized confederacy of retaliatory tax regions.

The Commerce and Due Process Clauses were adopted by the Framers to inhibit these centrifugal tendencies. The challenged tax should be invalidated under the Due Process and Commerce Clauses because it is not "fairly calculated" to attribute to New Jersey only the State's "fair share" of the taxpayers' incomes. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 506 (1942); *Freeman* v. *Hewitt*, 329 U.S. 249, 253 (1946). In addition, the challenged tax violates the Commerce Clause by singling out out-of-state activity for disfavored tax treatment. In so doing, the New Jersey taxation scheme threatens central Commerce Clause values: the prevention of "economic Balkanization," *Hughes* v. *Oklahoma*, 441 U.S. 322, 325-26 (1979), and the preservation of the "national free trade area." *American Trucking Ass'ns*, 107 S. Ct. at 2841; *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 328-29 (1977).

ARGUMENT

I. New Jersey's Taxation Scheme Is Calculated to Attribute to New Jersey More Than Its "Fair Share" of Multistate Corporate Income.

The fundamental criterion for judging the constitutionality of a state's taxation of a unitary, multistate business is that the

state's tax code must be reasonably calculated to attribute to that state only its fair share of the business's income. *See, e.g.*, *Butler Bros*, 315 U.S. at 506 (method of calculation must be "'fairly calculated' to assign to [the state] that portion of the net income 'reasonably attributable' to the business done there"); *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 169 (1983) (apportionment formula must be "fair," meaning that, *inter alia*, the "factors used . . . must actually reflect a reasonable sense of how income is generated"); *Freeman* v. *Hewitt*, 329 U.S. at 253 (interstate commerce can be required to pay only its "fair share" of costs of local government). A state taxation scheme that is calculated to assign to the state more than its fair share of the unitary taxpayer's income violates not only the taxpayer's due process rights, but also the Commerce Clause by "'exacting more than a just share from the interstate activity.'" *Tyler Pipe Indus., Inc.* v. *Washington State Dep't of Revenue*, 107 S. Ct. 2810, 2820 (1987), *quoting Washington Dep't of Revenue* v. *Association of Washington Stevedoring Cos.*, 435 U.S. 734, 738 (1978).

As corollaries to this fundamental principle, once a state has shown that its tax code is, on its face and in practical effect, reasonably calculated to attribute to the state its fair share of interstate corporate income, the state has essentially satisfied its constitutional obligations; that is, it has no duty to ascertain that its taxation provisions actually yield the state its "correct" share of a corporation's income, as measured by geographical accounting or any other method. *Container Corp.*, 463 U.S. at 182.

Equally, once the taxpayer has shown that the state's taxation scheme is not reasonably calculated to reach a fair result, the taxpayer has met its burden, and need not show that the result generated by applying the state's tax code to the corporation is substantially at variance from a hypothetical "correct" out-

come.[8] *See F.W. Woolworth Co.* v. *Taxation and Revenue Dep't*, 458 U.S. 354, 372-73 (1982) (New Mexico's requirement that corporate taxpayers add to their net incomes "fictitious" gross-up amounts "deemed received" from non-unitary subsidiaries invalidated without consideration of extent of the disproportion created by the requirement). *See also Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 269 (1984) ("[i]t is well settled that '[w]e need not know how unequal the Tax is before concluding that it unconstitutionally discriminates'"), *quoting Maryland* v. *Louisiana*, 451 U.S. 725, 760 (1981).

New Jersey's definition of "net income" is not reasonably calculated to assign to New Jersey its fair share of the taxpayers' incomes because it disallows the deduction of a cost which is and can be incurred only out-of-state. Accordingly, disallowance of WPT costs will raise the amount of corporate income attributable to out-of-state activities while not imposing any additional tax burdens on in-state activities.

The New Jersey CBT would no more be reasonably calculated to reach a fair result if it explicitly denied deductions for expenses incurred out-of-state, such as if it explicitly singled-out for denial the deductibility of costs incurred in the construction of buildings in New York. Such an exclusion would be more brazen, but its effect would be identical. Indeed, if New Jersey's view as to its unlimited power to define "net income" were correct, it would follow that even such blatant exclusions from deductible expenses would be constitutionally permissible. That surely is not the case.

---

[8] While a taxpayer may, in the alternative, prevail by demonstrating that, as applied to itself, even a fair formula has yielded a greatly disproportionate outcome, *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 121 (1931), the interest of the *amici* is in the constitutionality of New Jersey's taxation scheme itself, not in the quantitative result as applied to particular taxpayers.

Even if New Jersey could deny the deductibility of all building construction expenses, the Constitution requires that, if some construction costs are deductible, other construction costs which can arise only out-of-state also must be allowed. In the instant case, New Jersey allows the taxpayer to deduct from its gross receipts the costs and expenses of doing business, including severance taxes. The singling-out of a particular cost, which can be incurred only out-of-state, is by definition not geared to reaching a fair result.[9]

New Jersey's repeated insistence that appellants have not proven the *amount* by which the challenged law overstates New Jersey's share of their incomes, or that such amount was excessive, is therefore a *non sequitur* that betrays a misapprehension of the fundamental principles discussed above. The challenge here is to New Jersey's right to require the add back of the WPT tax expense *at all*. This requirement is patently calculated to accord to New Jersey more than its fair share of the taxpayers' incomes.

[9] The Solicitor General states that he has some difficulty in determining whether the WPT is more like a severance tax than an income tax. We fail to see the problem. For all the reasons stated in the Brief for the United States at 25-28, the WPT looks like a severance tax, operates like a severance tax and was intended as a severance tax. It simply bears no resemblance to the federal income tax. The fact that New Jersey has labeled it an "income or profits" tax is irrelevant: New Jersey can call the WPT a gift tax if it chooses. The constitutional analysis is not affected one whit by the labels chosen by a state. *See McLeod* v. *J.E. Dilworth Co.*, 322 U.S. 327, 331 (1944) (state court cannot "'render valid, by misdescribing it, a tax law which in substance and effect was repugnant to the Federal Constitution'"). *Cf. Tyler Pipe*, 107 S. Ct. at 2820 ("[t]he fact that the B&O tax 'has the advantage of appearing nondiscriminatory' . . . does not save it from invalidation"). A state tax is judged by what it is, not what it is called.

II. New Jersey's Add-Back Requirement Discriminates Against Interstate Commerce.

New Jersey's add-back requirement disallows the deduction of a particular cost that *cannot* be incurred in New Jersey. One would think that merely to describe this requirement is to demonstrate that it discriminates against interstate commerce, just as surely as if New Jersey explicitly required taxpayers to add back *all* costs and expenses that are incurred outside the state.

As discussed below, the dangers inherent in the New Jersey taxation scheme are precisely those at which the Commerce Clause was directed: "economic Balkanization;" disproportionate burdening of out-of-state activities; and obstruction of the "national free trade area." New Jersey ignores these dangers, asserting that the Commerce Clause applies only where a state bestows the fruits of its discrimination on a particular local industry. This interpretation ignores the central purposes of the Framers in adopting the Commerce Clause, as well as numerous decisions of this Court in interpreting it.

A. *The New Jersey Taxation Scheme Provokes "Economic Balkanization" by Exploiting Disparities Between the States.*

The central concern of the Framers in adopting the Commerce Clause was to prevent "economic Balkanization" of the states. *Hughes* v. *Oklahoma*, 441 U.S. 322, 325-26 (1979). The Framers were all too aware of the "drift toward anarchy and commercial warfare between [the] states" under the Articles of Confederation. *H.P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 533 (1949). In sound reaction to the "'mutual jealousies and aggressions of the States, taking form in customs barriers and other economic retaliation,'" *Baldwin* v. *G.A.F.*

Seelig, Inc., 294 U.S. 511, 522 (1935), *quoting* 2 Farrand, *Records of the Federal Convention* 308 (1911), the Framers formulated the Commerce Clause to "provide for the harmony and proper intercourse among the states." The Federalist No. 41, at 291-92 (J. Madison) (H. Dawson ed. 1863). Among other things, the Commerce Clause was intended to restrain "the desire of the commercial states to collect, in any form, an indirect revenue from their uncommercial neighbors. . . ." *Id.* at 292.[10]

When one considers the uneven distribution of natural resources between the various states and regions of this nation, it is clear that New Jersey's effort "to collect . . . an indirect revenue from . . . [its] neighbors" will tend to create just the sort of "economic Balkanization" feared by the Framers. New Jersey's add-back requirement exploits the uneven distribution of natural resources by making a tax advantage out of the State's lack of crude oil. This is a clever maneuver, and may afford the State an immediate financial benefit, but it is a street that goes both ways. Louisiana and Oklahoma are equally

[10] As explained by Justice Jackson, the heavy taxes imposed by the Colony of New York on the commercial activities of its neighbors, and the resulting retaliatory measures, were a dominant force behind the adoption of the Constitution:

> The unedifying story of Colonial rivalry in preying upon commerce, which more than any one thing made our Federal Constitution a necessity, is too often told by historians to justify repetition. . . . In 1787 New York was being supplied with firewood from Connecticut and much farm produce from New Jersey. It seized upon "local incidents" to lay a tax. Every sloop which came down through Hell Gate . . . and every market boat rowed across the Hudson River had to pay heavy entrance duties. Then came retaliatory measures. . . . These chronic quarrels were destroying the trade of all the rivals, and it was sought by the Constitution to free trade from local burdens and controls.

Independent Warehouses, Inc. v. *Scheele*, 331 U.S. 70, 94 (1947) (Jackson, J., dissenting).

capable of identifying resources which they lack but which are present in New Jersey, and of disallowing deductions for costs associated with the production of those resources.

It takes little imagination to see that if New Jersey is permitted to raise $88 million solely at the expense of out-of-state activities, then other states will seek to do the same. If New Jersey can refuse to recognize deductions for oil tax costs, then Alaska, a national leader in oil production, may seek to disallow deductions for expenses incurred in computer and data processing services, which are negligible factors in Alaska's economy.[11] Similarly, if New York, which has no coal production,[12] can refuse to allow deductions for coal severance taxes, then the coal-producing states may disallow deductions for stock transfer taxes, which at times have been a "source of substantial revenue" for New York. 1 J. Hellerstein, *State Taxation* 145 (1983).[13]

The regional rivalries of our time — Sun Belt versus Rust Belt, oil-producing states versus oil-importing states — would be foreign to the Framers, but the spectacle of states using their natural advantages and disadvantages to extract benefits from their sister states would be depressingly familiar and

[11] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585, 611 (1986). Alaska, the nation's second-largest producer of petroleum, *id.* at 585, has only 28 business establishments involved in computer and data processing services, fewer than any other state in the nation. *Id.* at 611 (1982 data). In 1982 alone, receipts from such services in New Jersey totalled $1.2 billion, *88 times* the amount of such receipts in Alaska. *Id.* at 612.

[12] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

[13] The New York stock transfer tax, N.Y. [Tax] Law § 270 (McKinney 1986) is imposed, *inter alia*, on all sales of securities occurring within New York, which necessarily includes all sales on the New York Stock Exchange. There are no stock exchanges in the major coal-producing states — West Virginia, Kentucky, Wyoming — and, not surprisingly, there are no stock transfer taxes in those states either. *See U.S. Department of Commerce, State and Metropolitan Area Data Book* 585 (1986); Hellerstein, *supra* at 20-21.

would be readily recognized as part of that class of conduct which it was the purpose of the Commerce Clause to eliminate. *See* The Federalist No. 22, at 140 (A. Hamilton) (H. Dawson ed. 1863).

B. *New Jersey's Disproportionate Taxation of Out-of-State Activities Compels Intense Scrutiny Under the Commerce Clause.*

State laws which disproportionately burden out-of-state activities are a particularly fertile source of interstate rivalries and reprisals. Burdened outsiders, having little influence on the taxing state, inevitably turn to their own states for redress, giving rise to continuing cycles of retaliatory state laws. As this Court recognized in invalidating New Hampshire's "commuter" income tax:

> Since nonresidents are not represented in the taxing State's legislative halls . . . judicial acquiescence in taxation schemes that burden them particularly would remit them to such redress as they could secure through their own State; but "to prevent [retaliation] was one of the chief ends sought to be accomplished by the adoption of the Constitution."

Austin v. *New Hampshire*, 420 U.S. 656, 662-63 (1975), *quoting Travis* v. *Yale & Towne Mfg. Co.*, 252 U.S. 60, 82 (1920).

For this reason, scrutiny under the Commerce Clause is particularly heightened where the burden of the challenged state law "bears disproportionately on out-of-state residents and businesses." *Kassel* v. *Consol. Freightways Corp.*, 450 U.S. 662, 675-76 (1981) (invalidating Iowa truck-length limitations which disproportionately burdened out-of-state carriers). *See also Raymond Motor Transp., Inc.* v. *Rice*, 434 U.S. 429, 447 (1978); *Southern Pacific Co.* v. *Arizona*, 325 U.S. 761, 767-68 n.2 (1945).

Of all the possible ways in which a state can disproportionately burden out-of-state activities, unrepresentative state taxation schemes pose the greatest dangers of inciting reprisals and retaliation. For example, Texas might or might not be willing to enact its own truck-length limitation in retaliation for an Iowa limitation that adversely affected Texan trucking companies. On the other hand, all states always have an interest in raising taxes, particularly if the increase can be imposed on exclusively out-of-state activities. The oil-producing states would need little encouragement to impose retaliatory taxes against New Jersey if such taxes could constitutionally be assessed solely on activities conducted in New Jersey.

State taxes which disproportionately burden out-of-state activities are not only more dangerous than similarly discriminatory state regulations, they are also less entitled to the traditional deference accorded to state enactments. Because "revenue serves as well no matter what its source," *Freeman* v. *Hewitt*, 329 U.S. 249, 253 (1946), it is fair to presume that the *only* reason a state would have for singling out out-of-state activity for particular tax burdens is to lessen the burden on local activities.[14] The ordinary presumption that a state has a valid reason for enacting a regulation is therefore entitled to

[14] New Jersey's hypothetical regarding the disallowance of expenses incurred in casino gambling, Brief of Appellee in Response to the United States, at 9, may be the exception that proves this rule. There may be situations in which a state has a genuine moral or other policy basis for denying a deduction which happens to arise exclusively out-of-state. Whether the disallowance of such deductions is constitutionally permissible need not be considered here, although we daresay that New Jersey would be the first to cry foul if a sister state were to deny the deductibility of casino-related expenses. In any event, this example serves to highlight the lack of any legitimate state interest in the present add-back requirement.

little if any weight in the field of taxation. This heightened scrutiny over state tax laws entirely distinguishes the present case from *Exxon Corp.* v. *Governor of Maryland*, 437 U.S. 117 (1978), on which the state has so heavily relied.[15]

C. *The New Jersey Taxation Scheme Threatens to Obstruct the "National Free Trade Area" by Discouraging Interstate Corporations From Doing Business in New Jersey.*

The New Jersey add-back requirement also threatens another central goal of the Commerce Clause: the creation of a "national

[15] Regulations imposed under the state's police power are accorded more deference than state tax laws because there may well be circumstances in which a substance or practice which happens to originate exclusively outside the state is legitimately deemed by the state to constitute a threat to the health or safety of its population. A state is not precluded from regulating or banning a dangerous product simply because of the happenstance that the product is not produced locally. By contrast, revenue raised outside the state is by definition precisely equal in quality to that raised locally. This rather obvious distinction between the state's regulatory authority and the state's taxation authority demonstrates the inaptness of the State's reliance on *Exxon*. In *Exxon*, the Court ruled that Maryland could rationally conclude that the prohibited form of ownership had contributed to inequities in the distribution of an essential resource during a time of shortages. *Id.* at 121, 124-25. Having accepted Maryland's asserted rationale, it required no great leap to uphold the regulation despite its exclusive burden on out-of-state companies. By analogy, if Maryland had reasonably concluded that a particular chemical was too dangerous to be permitted in-state, a ban on that chemical would surely be legitimate even if its sole source was out-of-state. By contrast, New Jersey cannot assert that revenue derived from taxing out-of-state activities serves any legitimate need of the State better than nondiscriminatorily raised revenue. *See Freeman* v. *Hewitt*, 329 U.S. at 253 (because state has no need for revenue from a particular source, taxation of interstate commerce has "always been more carefully scrutinized and more consistently resisted than police power regulations of aspects of such commerce"). *Cf. Bacchus Imports*, 468 U.S. at 272 (while states may compete for a share of interstate commerce, they may not use their taxation powers as the means toward that end).

free trade area." *American Trucking*, 107 S. Ct. at 2841. *See also Boston Stock Exchange*, 429 U.S. at 328, *quoting McLeod*, 322 U.S. at 330 ("'[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States'"); *Maryland* v. *Louisiana*, 451 U.S. 725, 754 (1981).

As explained by Judge Posner, when states "export their tax burdens" by imposing disproportionate tax burdens on multistate businesses, the interstate business is

> compelled to pay a higher tax than if it operated in only one state . . . . The result is to create an inefficient incentive to do business in as few states as possible.

R. Posner, *Economic Analysis of Law* 608 (3d ed. 1986). In the "national free trade area" created by the Commerce Clause, state boundaries are to be "economically irrelevant." *American Trucking*, 107 S. Ct. at 2840-41. State taxes which, like New Jersey's add-back requirement, impose disproportionate burdens on out-of-state activity, make state boundaries not only relevant but all-important, thereby discouraging interstate corporations from doing business in the taxing state. Even the most financially secure of the members of the *amici* organizations could not continue doing business in all fifty states if each state were to impose substantially disproportionate taxes on exclusively out-of-state activities.

D. *New Jersey's Restrictive Interpretation of the Commerce Clause Ignores Its History, Its Purposes and Its Interpretation by this Court.*

The New Jersey Supreme Court shrugged off the serious threats to Commerce Clause values posed by the add-back

scheme, asserting that there is no discrimination against interstate commerce unless the state favors a local industry similarly situated to the disfavored out-of-state businesses.[16] Under New Jersey's view, New Jersey could disallow the deduction of *any* cost incurred in, say, Texas: the *generalized* benefit to the entire state in reducing all in-state tax bills does not count, according to the State, as "discrimination," because there is no particular in-state industry being favored. New Jersey thus reduces the Commerce Clause to an equal rights act as between local and out-of-state industries. This reading of the Commerce Clause ignores its central purposes, as discussed above, and is flatly inconsistent with numerous decisions of this Court. Indeed, it is unimaginable that the narrow meaning suggested by New Jersey would be all there is to the clause which, after all, was "[t]he sole purpose for which Virginia initiated the movement which ultimately produced the Constitution." *H.P. Hood,* 336 U.S. at 533.

New Jersey's argument, in essence, is that the applicability of the Commerce Clause depends on what the state *does* with the fruits of its discrimination. New Jersey asserts that the Commerce Clause is not implicated unless those benefits are bestowed upon a particular local industry as opposed to being spread among the state's citizenry as a whole. The basis for such a distinction is nowhere found in the history or purposes of the Commerce Clause. To the contrary, the tendency of New Jersey's unrepresentative tax to promote "economic Balkanization" and to endanger the national free trade area is every bit as great as if the benefits were directed to a particular local industry. *See South Carolina State Highway Dep't* v. *Barnwell Bros., Inc.*, 303 U.S. 177, 184 n.2 (1938).[17]

[16] Appendix A to Jurisdictional Statement of Amerada Hess Corporation Appellants at 34a.

[17] The State's argument that the Commerce Clause is aimed *only* at rectifying unfairness between particular competitors is strikingly foreign to our ordinary understanding of the role of public law in our private enterprise system. Generally, we expect public law to intervene in disputes between private competitors only in the service of some greater public interest. For example, the antitrust laws protect competition, not competitors. *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977). One can imagine a state arguing that constitutional values are not implicated when what is at stake is only a dispute between private competitors. But for New Jersey to argue that Commerce Clause values cannot be vindicated unless one private competitor has obtained an unfair advantage over another seems like the tail wagging the dog. *See Exxon Corp.* v. *Governor of Maryland*, 437 U.S. 117, 127 (1978) ("the [Commerce] Clause protects the interstate market, not particular interstate firms . . .").

The ultimate proof of the error in New Jersey's interpretation is that it is flatly inconsistent with numerous decisions of this Court. State laws have frequently been invalidated under the Commerce Clause without there being any particular local competitor favored by the offensive regulation, but merely a generalized benefit to the state as a whole. Most strikingly, in *City of Philadelphia* v. *New Jersey*, 437 U.S. 617 (1978), New Jersey made the very same argument it makes here: that the Commerce Clause was not implicated by the State's ban on the disposal of wastes from outside the State because " '[n]o New Jersey commercial interests stand to gain advantage . . . as a result of the ban. . .' " *Id.* at 626 (*quoting* New Jersey's brief). The Court rejected this argument out-of-hand as irrelevant. *Id.* The Commerce Clause was violated by the State's creation of a benefit to its citizenry as a whole at the expense of its sister states. *Id.* at 626-28. *City of Philadelphia* v. *New Jersey* presented the strongest possible case for New Jersey's proposed rule: not only was there no local industry *favored* by the waste disposal ban, it was in-state business — the local owners of waste disposal sites — that suffered the pecuniary losses created by the regulation. *Id.* at 626. The State's argument failed there and must also fail here: a state enactment can discriminate against interstate commerce without discriminating in favor of a particular local industry.

Similarly, in *Tyler Pipe*, the Court held that Washington's manufacturing tax exemption "discriminates against interstate commerce," 107 S. Ct. at 2820, even though it was local industry which, far from being favored by the tax scheme, had to pay the "double" tax. In *Tyler Pipe*, the same local manufacturer paid lower taxes when selling in-state than when selling out-of-state: as here, the forbidden discrimination created by the taxation scheme was against interstate activity itself. *See also Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388, 393 (1984) (New York's export tax credit discriminated against out-of-state activity and created general benefit to State by offering tax exemption for only those exports shipped from New York; no particular in-state industry was favored because the same taxpayer — local or out-of-state — paid less tax to the extent it shipped from New York); *Bacchus Imports*, 468 U.S. at 268 n.8 (1984).

It is true that the cases have often described discriminatory taxes as favoring local businesses. *See, e.g., Boston Stock Exchange*, 429 U.S. at 329; *Maryland* v. *Louisiana*, 451 U.S. at 754; *Bacchus Imports*, 468 U.S. at 268. Those descriptions, however, were written in a different context: they applied to cases in which the state was trying to use its taxation system to promote some social goal other than raising revenue: e.g., discouraging sales on regional, out-of-state stock exchanges, *Boston Stock Exchange*, 429 U.S. at 331; promoting investment in in-state mineral exploration, *Maryland* v. *Louisiana*, 451 U.S. at 757; and encouraging development of the local liquor industry, *Bacchus Imports*, 468 U.S. at 265. The opinions in those cases appropriately were limited to the circumstances they presented. The New Jersey tax challenged here, by contrast, is aimed very simply at raising revenue, albeit in a discriminatory manner. Discrimination is as possible and as much prohibited when the state uses its tax system simply to raise revenue as when it employs its tax code in the

service of some other social goal. The formulaic approaches suitable to the latter situations, however, may not be applicable in the former context.

Apparently as a consequence of the obvious unfairness and discrimination against interstate commerce created by its add-back requirement, the State has been reduced to arguing that, if the Court disallows New Jersey's blatantly discriminatory add-back requirement, there may be line-drawing problems in future cases where the discrimination is less blatant. That argument requires little response. As an initial matter, the present case poses no line-drawing problems. There is no crude oil production in New Jersey, and, absent some geological breakthrough, there never will be. Thus, there is no question here of de minimis exceptions or of likely changes in the future.

As for the possibility that future cases will require line-drawing judgments, that fact does not distinguish this case from the vast majority of cases decided by this Court. Almost every rule of law enunciated by this Court creates the possibility that lower courts will have to engage in line-drawing to apply the law to the facts of future cases. The judgments that may be required by the various hypotheticals presented by the State are in no respect exceptional, nor do they present any challenges not surmountable by the standard judicial methods for resolving such issues, namely presumptions, burdens of proof, de minimis exceptions, threshold showings, and so forth.

The New Jersey add-back requirement is a blatant discrimination against out-of-state activity that allows New Jersey to shift a substantial amount of its tax burden to business activities which are necessarily performed in other states. In the words of Justice Jackson: "If [this tax] is valid, I know of no reason why the community should bear any of its own tax burdens." *Independent Warehouses, Inc.* v. *Scheele*, 331 U.S. 70, 95 (1947) (Jackson, J., dissenting).

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed.

Respectfully submitted,

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Nos. 87-453 and 87-464

In The

Supreme Court of the United States

October Term, 1988

Amerada Hess Corporation, et al.,

Appellants,

v.

Director, Division of Taxation,

Appellee.

Texaco Inc. and Tenneco Oil Company,

Appellants,

v.

Director, Division of Taxation,
New Jersey Department of the Treasury,

Appellee.

On Appeals from the Supreme Court of New Jersey

BRIEF OF AMICI CURIAE IN SUPPORT OF THE APPELLEE BY THE STATE OF IOWA, AND THE STATES OF CALIFORNIA, FLORIDA, GEORGIA, IDAHO, MICHIGAN, MONTANA, NEW YORK, NORTH DAKOTA, RHODE ISLAND, SOUTH CAROLINA AND WYOMING

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INTEREST OF AMICI CURIAE

Pursuant to United States Supreme Court Rule 36, the signatory States submit this Brief as Amici Curiae in support of the Appellee. Since this Brief is sponsored and filed by the aforementioned States, consent to its filing is not required. United States Supreme Court Rule 36.4.

Some of the Amici States have significant oil production while others have little or none. Some of the Amici States disallow a deduction for the windfall profit tax in the calculation of the State unitary net income base subject to apportionment. Others allow the WPT as a deduction. All Amici States employ the unitary business principle in connection with their State taxes measured by net income upon corporations.

All of the Amici States share a common concern which has led to the filing of this Brief. Amici are concerned that Appellants' position that there is an inherent geographic skewing of the unitary net income base in this case unduly encroaches upon State use of the unitary business principle. Amici strongly believe that a disallowance of a cost, such as the WPT, in calculating net income is related to the profitability of the unitary business as a whole. To say otherwise, as Appellants do with their argument that an inevitable geographic imbalance occurs, would erode the States' ability to exercise a reasonable discretion in defining a unitary net income base. Appellants' position is a blatant attempt to convince this Court to sanction a separate accounting inroad to the unitary business principle.

ARGUMENT

I. DENIAL OF WPT AS DEDUCTION IN CALCULATING APPORTIONED STATE TAX ON OR MEASURED BY NET INCOME DOES NOT INHERENTLY RESULT IN EXTRATERRITORIAL TAXATION IN VIOLATION OF THE DUE PROCESS CLAUSE AND THE COMMERCE CLAUSE.

Appellants make two basic arguments in this phase of their Appeal. First, they contend that the New Jersey Corporation Business Tax (CBT), by disallowing the federal windfall profit tax (WPT) as a deduction, creates a geographic bias in the preapportionment net income base so that the resulting apportionment will unreasonably attribute net income to New Jersey. They claim that such geographic imbalances must occur when the unitary net income base includes receipts from the entire unitary business but not all related costs, such as the WPT, which they claim are incurred only outside the taxing State. Second, they contend that the disallowance effectively imposes the CBT as a windfall profit tax upon oil production outside the State. The Solicitor General has filed a brief in which he states that the New Jersey CBT raises substantial federal questions with respect to denial of a WPT deduction.

A. A Nonproducing State's Disallowance Of WPT As A Deduction In Calculating A Unitary Tax Base Composed Of Net Income Does Not Create An Inherent Geographic Bias In Favor Of The Nonproducing State.

Appellants assume that the WPT is a site-specific cost having nothing to do with New Jersey where no oil is

produced. They argue that the CBT cannot constitutionally disallow the WPT as a deduction because there is no comparable in-State outlay for which deduction is disallowed in computing the CBT. "A taxing jurisdiction is free to permit or deny deductions for such geographically dispersed costs without risk of creating an inherently asymmetrical tax base." (Appellants' Brief at 22).

Amici contend that the alleged geographical bias is contrived by Appellants. The application of the unitary business principle effectively bars Appellants' extraterritorial taxation claims. In any event, a portion of windfall profit is likely, as a matter of economic substance, to be incurred in New Jersey so as to justify the WPT deduction disallowance under Appellants' theory of deduction disallowance for geographically dispersed costs.

1. Appellants' Claim Of Geographic Bias Is Contradicted By The Unitary Business Principle.

The unitary business/formula apportionment method "calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 165 (1983). Although not unfettered, the States possess great leeway,

both in their definition of the scope of the unitary business and in their choice of the apportionment formula. *Container*, 463 U.S. at 164, 167.

The unitary net income base may include only unitary operating net income of a single corporation, *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920), may include unitary operating net income and unitary investment net income of a single corporation, *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), or may include the unitary net income of all corporate affiliated members of the unitary enterprise, *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). In addition, the factor or factors in the apportionment formula selected by the States need not be uniform among the States. *Moorman Manufacturing Company v. Bair*, 437 U.S. 267, 278-280 (1978). Thus, a State may select from a variety of methods to calculate the unitary net income base or the apportionment formula, notwithstanding that these methods inevitably attribute different increments of income to the same income producing activities in the State. These inevitable differences have not, by themselves, been held by this Court to result in extraterritorial taxation.

Given that the unitary net income base subject to apportionment need not be uniformly computed, it follows that the States have great leeway in their definition of "net income" which constitutes that base. Indeed, in *Atlantic Coast Line Railroad Company v. Daughton*, 262 U.S. 413, 422, n. 6 (1923), the Supreme Court observed with respect to the makeup of the "net income" of a multistate enterprise:

> The term 'net income' in law or in economics has not a rigid meaning. Every income tax act necessarily defines what is included in gross income; what deductions are to be made from the gross to ascertain net income; and what part, if any, of the net income, is exempt from taxation. These details are largely a matter of governmental policy. As to them states differ; and there is apt to be difference of view in the same states at different times; and at the same time a different definition of taxable net income for different classes of taxpayers. Obviously, such differences in detail do not render obnoxious to the commerce clause a state income tax which is otherwise unobjectionable.

Appellants, being unitary businesses, are unable to demonstrate the precise sources of their net incomes which are earned as a result of "functional integration, centralization of management, and economies of scale" which are "factors of profitability" that "arise from the operation of the business as a whole." *Mobil Oil*, 445 U.S. at 438; *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 222 (1980). Therefore, attempts to match any cost solely with a particular portion of a unitary business run the risk of ignoring or capturing "inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container*, 463 U.S. at 164-5.

Three cases run counter to Appellants' site-specific economic theory that the WPT must inherently be allowed by a nonproduction State as a deduction in determining net income of a unitary business to avoid a geographic distortion of the tax base. In each case, this Court rejected taxpayer arguments of unconstitutional

extraterritorial taxation and, instead, indicated a wide leeway of tolerance for apportioned State taxes.

In *Moorman Manufacturing Company v. Bair,* 437 U.S. 267 (1978), this Court held that the Iowa single factor sales formula did not inherently result in extraterritorial taxation, even though that formula did not include the property and labor of the taxpayer, whose Iowa activities consisted of marketing its products which it manufactured outside the State. The rationale in *Moorman* will not support an argument that there is an inherent malapportionment of net income associated with the taxpayer's in-State activities merely because the manufacturing components, although included in the net income base as deductions, for example, depreciation and payroll expense, are not included as property and payroll factors in the apportionment formula. In addition, this Court noted the divergence in the definition of "nonbusiness income." 437 U.S. at 279. By analogy, it cannot be said that a definition of net income which does not allow a deduction of the WPT expense which is incurred by the unitary business, so that it is functionally related to activities in the taxing State and elsewhere, violates the Constitution by resulting in inherent extraterritorial taxation.

In *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983), the taxpayer, in arguing against an income apportionment upon a combined report basis which included net income from foreign subsidiaries, asserted that lower wages in foreign countries lead to lower costs of production there so that the standard three factor formula, which included wages, caused a geographical bias that unreasonably increased income attributable to taxpayer's operations in the taxing

State. The taxpayer's evidence demonstrated such disparity in wage rates and, further, that the lower foreign wages were not balanced by lower foreign productivity levels. The Supreme Court rejected the argument that the application of the standard three factor formula, under these circumstances, created a geographical bias and distorted result. This Court stated in 463 U.S. at 182:

> The problem with all this evidence, however, is that it does not by itself come close to impeaching the basic rationale behind the three-factor formula. Appellant and its foreign subsidiaries have been determined to be a unitary business. It therefore may well be that in addition to the foreign payroll going into the production of any given corrugated container by a foreign subsidiary, there is also California payroll, as well as other California factors, contributing – albeit more indirectly – to the same production.

In *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207 (1980), the taxpayer alleged that its vertically integrated oil business was subject to invalid extraterritorial taxation by the taxing State of Wisconsin in which no oil was produced. This Court rejected that allegation and found a proper relationship "between the income attributed to the State by the apportionment formula and the intrastate value of the business." 447 U.S. at 227. In *Exxon,* the taxpayer argued that Wisconsin was imposing its tax upon the taxpayer's production income that occurred wholly outside the State. This Court rejected that argument and treated the production activities as contributing to the profitability of the whole unitary business. Likewise, the WPT is associated with the profitability of the entire unitary business. Therefore, *Exxon* forecloses Appellants' argument that a disallowance of a

deduction, even if constituting an out-of-State cost, inherently results in extraterritorial taxation.

In the instant case, the alleged geographical distortion caused by New Jersey's refusal to allow Appellants to deduct their WPT in the calculation of their unitary net income bases is speculative. Since States are not rigidly required to define a unitary net income base in a manner which allows all costs to be deductible, New Jersey's refusal to authorize deduction of taxes imposed upon income or profits is a perfectly reasonable exercise of the State's power to define its tax policy. To say otherwise would be to introduce into the calculation of a unitary net income base a rigidity that would not be warranted. New Jersey has imposed a tax that, for all the record in the instant case shows, is imposed upon "a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State." *Moorman*, 437 U.S. at 273.

The importance to income production of each factor in the three factor property-payroll-sales formula is by no means ascertainable, so that giving each factor equal weight is "arbitrary." *Container*, 463 U.S. at 184, n. 20. Indeed, it may very well be that the New Jersey market place was "responsible for the lion's share of the income generated by" sales of Appellants' products in New Jersey. *Moorman*, 437 U.S. at 272. Certainly, nothing in the record in this case disproves this potential fact and, if it exists, there would be no geographical bias even if Appellants' theory as to the site-specific source of the WPT had some merit.

Appellants' geographical bias argument ignores the function of the unitary business,'formula apportionment method which is an attempt to value the income producing activities of the unitary business in the taxing State. This attempt passes constitutional muster as long as it produces a result that is "reasonably related to the activities conducted within the taxing State." *Moorman*, 437 U.S. at 273. In this regard, Appellants, in arguing that the New Jersey failure to authorize a deduction of WPT inherently results in extraterritorial taxation, seek to prevail where previous State income tax litigants have invariably lost. This Court has never held that a State income tax unitary business/formula apportionment method will *always* result in malapportionment. By contrast, this Court has made clear that Appellants' unproven and speculative allegation is not enough to show extraterritorial overreaching. *Moorman*, 437 U.S. at 272.

Instead, while overreaching has been occasionally found in the *application* of the unitary method, *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931), the taxpayer has the heavy burden of showing by clear and cogent evidence that an unreasonable apportionment or geographical bias has occurred in the application of that method. *Container*, 463 U.S. at 164; *Moorman*, 437 U.S. at 274.

In the instant case, there is no "clear and cogent evidence" that New Jersey's failure to allow WPT as a deduction in calculating net income has resulted in an improper skewing of the value of Appellants' income

producing activities in that State. The New Jersey decision to exclude the WPT as an allowable deduction cannot support any assumption of unconstitutional geographic bias in State taxation, regardless whether Appellants' position has merit "from the standpoint of economic theory or legislative policy." *Moorman*, 437 U.S. at 272. Therefore, even if the WPT were not imposed upon an activity in New Jersey, there is no evidence in this case that New Jersey's refusal to authorize it as a deduction automatically causes extraterritorial taxation of Appellants' income.

2. The WPT And The Windfall Profit Are Directly Associated With Appellants' Marketing Activities In New Jersey.

The WPT is a tax on additional or anticipated profits which were expected to accrue to the oil producers as a result of decontrol of oil prices. In *United States v. Ptasynoski*, 462 U.S. 74, 75-6 (1983), this Court stated:

> During the 1970's the Executive Branch regulated the price of domestic crude oil. See HR Rep. No. 96-304, pp. 4-5 (1979). Depending on its vintage and type, oil was divided into differing classes or tiers and assigned a corresponding ceiling price. Initially, there were only two tiers, a lower tier for "old oil" and an upper tier for new production. As the regulatory framework developed, new classes of oil were recognized.
>
> In 1979, President Carter announced a program to remove price controls from domestic oil by September 30, 1981. See id., at 5. By eliminating price controls, the President sought to encourage exploration for new oil and to increase production of old oil from marginally economic operations. See HR Doc. No. 96-107, p. 2 (1979). He recognized, however, that deregulating oil prices would produce substantial gains (referred to as "windfalls") for some producers.

> The price of oil on the world market had risen markedly, and it was anticipated that deregulating the price of oil already in production would allow domestic producers to receive prices far in excess of their initial estimates. See ibid. *Accordingly, the President proposed that Congress place an excise tax on the additional revenue resulting from decontrol.*
>
> Congress responded by enacting the Crude Oil Windfall Profit Tax Act of 1980, 94 Stat. 229, 26 USC § 4986 et. seq. (1976 ed, Supp V) [26 USCS §§ 4986 et. seq.]. The act divides domestic crude oil into three tiers and establishes an adjusted base price and a tax rate for each tier. See §§ 4986, 4989, and 4991. The base prices generally reflect the selling price of particular categories of oil under price controls, and the tax rates vary according to the vintage and types of oil included in each tier. . . .

(Emphasis supplied).

The Senate Report, concerning the proposed Windfall Profit Tax Act, stated that the "committee believes that the large price increases on previously discovered oil resulting from phased decontrol are an appropriate object of taxation." S.Rep.No.394,96th Cong.,2nd Sess.6 (1979). The House Report concurred by stating that "[t]he committee believes that there should be a tax on the windfall from decontrol of crude oil prices and from excessive increases in world prices." H.R.Rep.No.304,96th Cong.,2nd Sess.4 (1979).

The WPT is a tax "imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period." 26 U.S.C. § 4986(a). The WPT is "paid by the producer of the crude oil." 26 U.S.C. § 4986(b).

The amount of WPT is imposed with respect to the windfall profit for each "barrel of taxable crude oil." 26

U.S.C. § 4987(a). There are three tiers of oil subject to the WPT upon the windfall profit per barrel of integrated oil companies and each tier has a different tax rate known as "applicable percentage." 26 U.S.C. § 4987(b).

The "windfall profit" is calculated by subtracting from the "removal price" of a barrel of crude oil the "adjusted base price" and the "severance tax adjustment" with respect to that barrel. 26 U.S.C. § 4988(a). The "removal price" of a barrel of oil is either its actual sales price to third parties or a constructive sales price determined under 26 U.S.C. § 613. 26 U.S.C. § 4988(c). The "adjusted base price" of a barrel of oil is its base price multiplied by an inflation adjustment. 26 U.S.C. § 4989. In determining the "windfall profit" of a barrel of oil, the WPT Act provides that such "windfall profit" cannot be in excess of "90 percent of the net income attributable to such barrel." 26 U.S.C. § 4988(b).

Structurally, the Congress opted to impose the WPT upon a windfall profit per barrel of crude oil using in the windfall profit calculation a "removal price" that was either its actual sales price or its constructive sales price. Obviously, integrated oil producers, such as Appellants, who remove crude oil for sale off the production premises or who manufacture or refine products from their extracted crude oil, whether on or off the production premises, have not yet, by the mere act of "removal", recognized any profits or revenues as a result of decontrol of oil prices. That recognition will occur upon actual sale of the crude oil or the refined and manufactured oil products to third parties. The production activity is merely one in a series of activities whereby the unitary business actually earns the windfall profit that is subject to the WPT.

The integrated oil producers transfer (remove) crude oil from the production site to downstream facilities where the oil is commingled with oil from other sources, thereby making it impossible to trace any particular per barrel windfall profit. However, when oil or oil products emerge from downstream facilities and are sold in States, such as New Jersey, it is reasonable to assume that the artificially incurred windfall profit taxed by the WPT Act upon "removal" is now realized and is earned, in part, by the integrated producers' marketing activities in the States where sold. Accordingly, the economic reality or practical effect is that the windfall profit, resulting from oil price decontrol, is earned, due to the unitary nature of the business, "by a series of transactions beginning with the [exploration and extraction of oil outside the State] and ending in sales in [New Jersey] and other places." *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271, 282 (1924); *see Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

It is reasonable to assume that some windfall profit must be associated with sales of Appellants' oil products in New Jersey. But, it is impossible to ascertain the amount thereof due to commingling of oil so that the per barrel windfall profit cannot be traced to specific barrels of oil that were consumed in the refining and manufacturing of products sold in New Jersey.[1] However, the fact

[1]It is possible that some oil products sold in New Jersey were refined from oil which was not associated with WPT, either because the per barrel calculation was such that no windfall profit was incurred or because the oil was exempt from the WPT, for example, oil from sources outside the United States or oil exempt under 26 U.S.C. § 4991(b).

that Appellants, as integrated producer-marketers, market oil products in New Jersey assures that some windfall profit is included in the sales prices of the refined oil products and, as a result of their unitary business, is earned in part in New Jersey.

When Appellants' oil products are marketed in New Jersey, one must assume that windfall profit is included in the sales prices of such products. While Appellants emphasize that the WPT is due upon "removal" even if the oil is lost or otherwise never sold, the economic reality remains that the WPT was imposed upon the anticipated decontrolled revenues, in part due to Appellants' sales activities in New Jersey and elsewhere. The structural form of the WPT should not disguise the practical substance that there is likely to be actual windfall profit earned, in part, from Appellants' activities in New Jersey. It is unlikely that significant amounts of oil will be lost or otherwise unsold. The "practical effect" of the New Jersey CBT is controlling in this case. *Exxon*, 447 U.S. at 227-8.

For the WPT to be solely a site-specific cost, all windfall profit must have accrued at the production site. While windfall profit, namely, the additional revenue from decontrol, may be site-specific if the crude oil is sold to third parties at the production site, such site-specificity does not occur where the integrated oil producers remove crude oil to downstream facilities, as Appellants for the most part did. Under those circumstances, while the windfall profit is superficially deemed by Congress to occur upon "removal" at the production site, the windfall profit, in fact, cannot be deemed to solely accrue there. The windfall profit will accrue, in part, as a result of

Appellants' marketing activities of their oil products in New Jersey and elsewhere wherein they sell those products which they refined and manufactured from their extracted oil. Since the windfall profit, therefore, did not accrue solely at the production site and at least a portion of it accrued from marketing activities in New Jersey where higher prices as a result of decontrol were obtained, the WPT imposed upon that geographically dispersed windfall profit would not be sourced solely to the production site. In practical effect, the WPT geographically follows the windfall profit. Accordingly, by Appellants' own geographically dispersed costs test for State discretion to permit or deny deductions without creating an inherent geographic imbalance, (Appellants' Brief at 22), no such imbalance exists in this case.

B. Disallowance Of A Deduction For The WPT Does Not Operate As A Tax On the Removal Of Crude Oil From Out-Of-State Premises And Does Not Violate The Nexus And Fair Relationship Standards.

1. Appellants claim that disallowing a deduction from the New Jersey CBT base for the federal WPT is the same as imposing a New Jersey windfall profit tax on the out-of-State removal of oil. They claim that because New Jersey has no nexus with the out-of-State removal of oil, the disallowance of the deduction violates the nexus prong of the test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

Disallowing a deduction, however, is not the equivalent of imposing a tax. For example, if no deduction from the income tax base is allowed for sales tax, the state has not created another sales tax. If no deduction is allowed

for property tax, the State has not imposed a tax on the taxpayer's property. If no deduction is allowed for a severance tax, the State has not imposed a tax on severance.

Deductions are a matter of grace and a form of subsidy administered through the tax system which the legislature can disallow as it chooses. *Regan v. Taxation With Representation*, 461 U.S. 540, 544, 549 (1983). A State is not required to allow deductions for expenses of doing business, regardless of where those expenses may be incurred. This includes tax expenses such as the WPT. "Income", for State income tax purposes, need not be the net income left for the use and enjoyment of the taxpayer.

New Jersey in no way imposes a severance tax on out-of-State severance. Liability for the New Jersey CBT is not based upon the amount of oil removed from the ground or the value of the oil. The apportionment formula does not apportion barrels of oil to New Jersey. It apportions income. That income base may include a unitary business' total income. *Exxon Corp.*, 447 U.S. at 223. That total income may constitutionally be the income prior to payment of certain expenses, including the WPT expense.

Appellants argue that disallowing a deduction for the WPT acts as a severance tax because the WPT is a severance tax. The WPT is not a severance tax, however. It is a tax on income or profits. *Tenneco West, Inc. v. Marathon Oil Co.*, 756 F.2d 769, 772-73 (9th Cir. 1985); *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal. App. 3d 6, 189 Cal. Rptr. 302 (2d Dist. 1983). The WPT is imposed upon excess revenue realized as a result of

decontrol. *Tenneco West*, 756 F.2d at 773. The fact that liability for the tax is triggered by removal of the oil does not make it a tax on removal. It is the vintage and type of oil, and other factors specified in the Act, that determine whether WPT is due. *Id.*[2]

As previously discussed, the windfall profit is earned, in part, as a result of Appellants' New Jersey marketing activities. There is no violation of the nexus standard where New Jersey's CBT disallows as a deduction a cost, such as the WPT, which is associated with windfall profit activities in that State.

2. Appellants further argue that disallowing a deduction from the New Jersey CBT base for the WPT violates the fair relationship requirement of the *Complete Auto Transit* test. They claim that New Jersey is imposing a tax whose measure is a percentage of the value of the crude oil produced in another state, thereby bearing no relationship to the taxpayers' presence or activities in the State.

Appellants' claim is groundless. The measure of the New Jersey CBT remains *income*, with certain deductions allowed. Since income results when the oil is sold, the measure of the tax is related to Appellants' marketing activities in New Jersey. Appellants pay income tax to

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[2]The fact that some members of Congress may have characterized the WPT as a severance tax is irrelevant, especially since other members recognized the WPT as being a tax on profits. *See* 125 Cong. Rec. H17141 (Remarks of Rep. Lederer); 125 Cong. Rec. H17142 (Remarks of Rep. Shannon); 125 Cong. Rec. H17151 (Remarks of Rep. Ullman).

New Jersey not because of out-of-State oil production but because of their sales activities in New Jersey. In connection with those activities, New Jersey does afford protection and opportunities. Indeed, Appellants' marketing of oil is an integral part of their unitary businesses, important to assure full use of their production and refining operations. *See Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 225-26 (1980).[3]

When a tax is assessed in proportion to a taxpayer's activities or presence in New Jersey, the taxpayer is shouldering its fair share of supporting the State's provision of police and fire protection services, a trained work force, and the advantages of a civilized society. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 627 (1981). Those advantages constitute a long list, including such things as the maintenance of means of transportation and the various amenities which encourage the use and consumption of the products which directly add to Appellants' wealth.

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[3]Appellants erroneously assert that the increased value of crude oil due to decontrol bears no relationship to the producer's presence or activities in New Jersey. (Appellants' Brief at 40). Without a market for the oil, however, the oil would have no value. The presence of a New Jersey market for the oil affects the oil's value, including the value after decontrol. Therefore, the increased value of oil due to decontrol is directly related to the producers' activities in New Jersey.

In addition, as discussed, *supra*, at pp. 10-15, the windfall profit (and the WPT) are directly associated with New Jersey activities. The practical effect of the CBT, in disallowing a WPT deduction, is consistent with this association.

Appellants fail to prove that the disallowance of a WPT deduction causes the New Jersey income tax to be grossly out of proportion to the services provided by New Jersey. This is especially true since New Jersey could constitutionally tax Appellants' New Jersey gross receipts, which may well be a much larger tax base than is the New Jersey net income base after apportionment. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 280 (1978); *see Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 227 (1980).

II. DISALLOWANCE OF A DEDUCTION FOR THE WPT FROM THE CBT BASE DOES NOT IMPERMISSIBLY DISCRIMINATE IN VIOLATION OF THE COMMERCE CLAUSE OR THE EQUAL PROTECTION CLAUSE.

Appellants claim that the disallowance of a deduction for the WPT violates the Commerce Clause and the Equal Protection Clause because it imposes on crude oil production activities, which occur outside of New Jersey, a discriminatorily higher effective tax burden than that imposed on in-State business activities. This claim is unsupported by any comparison between similarly situated taxpayers or between comparable in-State and out-of-State activities or taxpayers.

A. The New Jersey CBT Does Not Impermissibly Discriminate Against Out-Of-State Business Operations, But Properly Treats Producers Differently Than Non-Producers.

Appellants are treated the same, for New Jersey CBT purposes, as are all other corporations that pay the WPT. They are not discriminated against in favor of other *similarly situated* taxpayers. Producer-marketers of petroleum are in fact different from nonproducer-marketers, as one

group directly benefited by the decontrol of oil prices and one did not. Producer-marketers of petroleum received the benefits of decontrol and higher oil prices which gave rise to the windfall profits taxed by the federal government. Nonproducer-marketers did not receive the benefits of decontrol (since they had to purchase their oil at the inflated prices) and accordingly paid no WPT. A State legislature could reasonably conclude that corporations paying WPT were in a better position to pay additional state CBT due to their receipt of substantial windfall profits which remained with these corporations even after payment of the WPT. *See* H.R.Rep.No.304,96th Cong.,2d Sess.72 (1979) (46 percent of unearned profits left with oil producers).

Different businesses may be taxed on different bases without violating the equal protection clause. The legislature may define "net income" as it sees fit as long as the statute has a rational relationship to the legitimate legislative purpose being accomplished. *See Atlantic Coast Line Railroad Co. v. Daughton*, 262 U.S. 413, 423-25 (1923). It has already been established that corporations receiving the windfall profits from oil price decontrol are sufficiently different from corporations who did not benefit from decontrol to warrant different tax treatment. Producer-marketers may constitutionally be classified differently from other marketers of petroleum products. A state legislature could reasonably conclude that producer-marketers' "corporate organization and the magnitude of their operations in every aspect of the petroleum industry, from the well to the gasoline pump, afforded [them] a

market power and economic advantage over their [non-producer-marketing] competitors and special opportunities to obtain the benefit of the conditions existing in the world-wide market." *Shell Oil Co. v. New York State Tax Com'n*, 91 A.D.2d 81, 458 N.Y.S.2d 938, 943 (1983). "The equal protection clause does not prevent a state from taxing such economic power and competitive advantages." *Id.*

B. Disallowance Of A Deduction For The WPT Does Not Discriminate Against Interstate Commerce Because It Does Not Favor Any Comparable In-State Activity Or Taxpayer.

1. Appellants agree that in disallowing a deduction for the WPT the New Jersey CBT does not favor New Jersey crude oil production. There is no tax burden imposed on out-of-State transactions which is not imposed on the same transactions conducted within the State. This is not a case, for example, where out-of-State depreciation or payroll is not allowed to be deducted while the same in-State expenses are allowed as deductions. The disallowance of the WPT deduction by New Jersey does not result in economic protectionism.

Appellants claim that New Jersey has singled out for special tax burdens a business activity that is conducted only in other states. They claim that they are "subjected to disproportionate tax levies solely on account of their business activities elsewhere." (Appellants' Brief at 44). There is no evidence in the record to support the claim of "disproportionate tax levies." None of Appellants' intrastate marketing competitors have the financial advantages of being an integrated producer-marketer "which

benefits from an umbrella of centralized management and controlled interaction." *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207, 224 (1980). It is likely that, even with the disallowance of a WPT deduction, Appellants' expenses connected with doing business in New Jersey are less than the expenses of intrastate nonproducer-marketers. After all, the nonproducer-marketers must purchase their products from producers who are going to charge the nonproducers an amount sufficient to return a profit. Also, the producers are the ones who benefit from the extra profits due to decontrol. There is no reason to believe that the New Jersey CBT increases interstate marketers' cost of doing business in New Jersey over that of intrastate marketers or imposes a disproportionate tax burden on the interstate producer-marketers. The tax burden may well be greater for the nonproducer-marketers.

Contrary to Appellants' assertion, they are not denied the deduction for the WPT "solely on account of their business activities elsewhere." (Appellants' Brief at 44). They are not denied a deduction for the WPT because they are engaged in interstate commerce or because they are out-of-State companies. The nonproducer-marketers who sell petroleum products in New Jersey are not necessarily purely local businesses but may also be engaged in interstate commerce. The denial of a deduction for the WPT is not based upon the interstate nature of Appellants' businesses and does not burden out-of-State companies, consumers, or transactions while favoring similar in-State activities. The distinction is between producers and nonproducers, and not between interstate and intrastate marketers. No corporation which is denied a deduction for the WPT is denied such deduction because it

engages in interstate commerce, but because it produces crude oil and pays the federally imposed WPT. If Appellants were interstate marketers which were not also producers of the oil they market, they would not be affected by the disallowance of a WPT deduction. Furthermore, as discussed above, the WPT is not related solely to out-of-State activities but is related to Appellants' marketing activities in New Jersey.

Appellants' argument regarding discrimination against interstate commerce is based upon the false premise that, since there is no crude oil production in New Jersey, there could be no New Jersey intrastate marketer corporation which incurs WPT. However, the federal WPT law imposes the WPT on any "holder of the economic interest with respect to the crude oil", i.e., those entitled to income from lifting the oil who thereby received financial benefits from decontrol through higher prices for their crude oil. 26 U.S.C. § 4996(a). The WPT is, thus, imposed upon the New Jersey lessor of out-of-State oil production wells.[4] Nothing precludes an intrastate corporate marketer from holding such an economic interest and therefore being an oil "producer" as defined in the WPT Act. Such an intrastate marketer would also be denied a WPT deduction for CBT purposes.

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[4]A New Jersey lessor of an out-of-State oil well can be an intrastate marketer because a lessor need not receive the crude oil or even be involved with oil production. The production and ultimate disposal of the oil, under these circumstances, is by the lessee. The lessor receives royalties as a result of production. Nevertheless, the WPT is imposed upon the lessor.

?. Appellants further complain that intrastate mark... who purchase their oil products from integrated oil producers are allowed to deduct their full cost of goods sold, which *may* include a WPT element, while integrated oil producers are not allowed to deduct the WPT. However, this is also true of *interstate* marketers who purchase oil products from integrated oil producers. They may also deduct any WPT element which is passed on to them in the sales price of the goods they purchase and, therefore, is in their cost of goods sold. Whether the WPT is nondeductible or excluded in the cost of goods sold of a taxpayer, for New Jersey CBT purposes, is wholly unrelated to whether the taxpayer is engaged in interstate commerce.[5]

Moreover, the WPT is not imposed on marketers with respect to oil products purchased from integrated oil producers. The WPT is imposed upon the oil producers. All marketers are entitled to exclude from their gross incomes their cost of purchasing oil. That cost contains many elements that integrated oil producers may choose to include or to "pass on" to their customers. When integrated oil producers, such as Appellants, purchase oil from others who pay the WPT and if the purchase price

[5]Unlike other Amici States, Iowa makes a distinction on the basis of whether the producer included the WPT in its inventory costs under 26 U.S.C. § 471 and Treas. Reg. § 1.471-11(c)(2)(iii) on its federal income tax return. *Shell Oil Co. v. Bair*, 417 N.W.2d 425, 428-9 (Iowa 1987). Such distinction is unrelated to the interstate nature of the producer's business. Likewise, those States which do not make the Iowa distinction have not disallowed the WPT deduction on the basis of interstate criteria.

of the oil includes a WPT cost element, integrated oil producers are likewise allowed, for New Jersey CBT purposes, to exclude such purchase price from gross income.

The illustration set forth at pages 45-46 of Appellants' brief fails in its attempt to show that integrated oil producers are taxed more heavily than the independent marketers with which they compete. First, as discussed above, the nonproducer's cost of goods sold will likely be greater than that of the producer, since the producer-marketer will charge the nonproducer-marketer enough to make a profit on the sale. Second, the tax burdens should not be compared "per barrel of product sold in New Jersey" (Appellants' brief at 46), but based upon income attributable to New Jersey. The groups being compared are not taxed on barrels of oil sold in the State but on *income*. Contrary to Appellants' speculative assertions, there is no proof that producer-marketers are at a "material economic disadvantage", bear a "higher effective tax cost" than the independent marketers, or pay more than their "just share." (Appellants' Brief at 45, 47, 49).

The Commerce Clause is not violated when state taxation affects a particular form of business organization, as long as any distinction is not based upon the in-State or out-of-State nature of the organization. In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), the Court held that a Maryland statute did not discriminate against interstate commerce in prohibiting the operation of gasoline stations by companies which refined or produced crude oil. Since no oil was produced or refined in Maryland, the statute prevented integrated oil producer-marketers from operating their own gasoline stations in

the state while leaving gasoline stations operated by non-integrated marketers unaffected. The Court pointed out that the distinction was not between in-State and out-of-State marketers, because several of the independent retailers were in fact interstate marketers:

> As the record shows, there are several major interstate marketers of petroleum that own and operate their own retail gasoline stations. These interstate dealers, who compete directly with the Maryland independent dealers, are not affected by the Act because they do not refine or produce gasoline. In fact, the Act creates no barriers whatsoever against interstate independent dealers; it does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between in-state and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce. *See, e.g., Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 53 L.Ed.2d 383, 97 S.Ct. 2434; *Dean Milk Co. v. Madison*, 340 U.S. 349, 95 L.Ed. 329, 71 S.Ct. 295. For instance, the Court in *Hunt* noted that the challenged state statute raised the cost of business for out-of-state dealers, and, in various other ways, favored the in-state dealer in the local market. 432 U.S., at 351-352, 53 L.Ed.2d 383, 97 S.Ct. 2434. No comparable claim can be made here. While the refiners will no longer enjoy their same status in the Maryland market, in-state independent dealers will have no competitive advantage over out-of-state dealers. The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.

(Footnotes omitted). *Exxon Corp. v. Governor of Maryland*, 437 U.S. at 125-26.

New Jersey treats all corporations upon whom the WPT is imposed exactly alike. This equality of treatment completely forecloses Appellants' interstate commerce discrimination claim.

CONCLUSION

The judgment of the Supreme Court of New Jersey should be affirmed.

Respectfully submitted,

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